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CHAPTER – 2
CONCEPTUAL FOUNDATION

Introduction

In this chapter the researcher has attempted to highlight the theoretical background of the study topic. Various aspects related to corporate governance have been enumerated.

2.1 Definition

Corporate governance by definition; is the code of practice by which a firm's management is held accountable to capital providers for the efficient use of assets.

It exhibits how its mission, its values and philosophy govern on organization

- Governance refers to the system of directing and controlling an organization.
- A good governance system.
- Generates ideas through participation of all stakeholders.
- Harmonies different viewpoints while protecting interests of the minority stakeholders.
- Governance assumes greater significance for publicly traded companies because of the separation of management from shareholders in general. Leading to conflict of interests of the management and shareholders.
- Pre-requisites of good governance are education, technical skills, core competency and a system of effective communication, both internal and external.
- The primary objective of the management of a publicly traded company is to enhance the value of the enterprise.
As a good corporate citizen, an enterprise is expected to honor and protect the rights of other stakeholders including the local community.

Increased competitiveness is all the more reason for the Management of the board to institute corporate Governance on highly ethical grounds all across the organization.

Governance refers to the system of directing and controlling an organization. The concept of corporate governance is defined in several ways because it potentially covers the entire gamut of activities having direct or indirect influence on the financial health of the corporate entities. Let us take a look at some definitions in the context of the present day situation.

1. According to Cadbury Committee Report, 1992, "Corporate Governance is the social, legal and economic process through which companies function and are held accountable"

2. According to some experts, "Corporate Governance means doing everything better, to improve relations between companies and their shareholders; to improve the quality of outside Directors; to encourage people to think long-term; to ensure that information needs of all stakeholders are met and to ensure that executive management is monitored properly in the interest of shareholders".

3. An article published on June 21, 1999 issue of the Financial Times J. Wolfensohn, President, World Bank as says that "Corporate Governance is about promoting corporate fairness, transparency and accountability".

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

Thus, in nutshell, corporate governance is the structure and process of:

(a) Monitoring executive performance,
(b) Ensuring accountability of management to shareholders,
(c) Motivating management towards creating value for shareholders, and
(d) Protecting interests of other stakeholders including the local community.

Corporate Governance means the idea of ensuring proper management of companies through the institutions and mechanism available to the shareholders. But the effective accountability to all stakeholders is the essence of corporate governance.

To have a clear understanding of the important aspect of the concept, some of the important definitions have been stated as below:

In the proceeding of the silver jubilee National Conventional of I.C.S.I., "Corporate governance is just Corporate Management; it is something much broader to include a fair, efficient and transparent administration to meet certain well defined objectives. It is a system of structuring, operating and controlling a company with a view to achieve long-term strategic goals to satisfy shareholders, creditors, employees, customers and suppliers and complying with the legal and regulatory requirements, apart from meeting environmental and local community needs. When it is practiced under a well laid out system, it leads to the building of a legal, commercial and institutional framework and demarcates the boundaries within which these functions are performed."
According to Dr. Geeta Gauri, "Corporate governance is a system by which companies are run. It relates to the set of incentives, safeguards and the disputes resolution process that are used to control and coordinate the actions of the agents on behalf of the shareholders by the Board of Directors. Shareholders are responsible for appointing the Directors and auditors.

Creating of residual value is the Primary concern of shareholders, but the process of values creation and its legality are equally important. Hence, corporate governance relates to conduct, the management of the companies observes while exercising its power. The Kumar Maugalam Committee acknowledges that the fundamental objective of Corporate Governance is "the enhancement of the long-term shareholders value, while at the same time protecting the interest of other stakeholders." The report points out that this definition harmonizes the need for company to strike a balance at all times between the need of enhance shareholders wealth whilst not in any way being detrimental to the interest of the other stakeholders in the company such as suppliers, customers, creditors, the bankers, the employees of the company, the government and the society at large. According to Cadbury Committee report, 1991, Corporate Governance is "a system by which corporate are directed and controlled". The focus was largely on accountability. In the words of Sir Sydney the Chairman of the financial reporting council of UK, the good corporate governance is "to ensure that the business is being soundly and effectively managed with risks being properly assessed and controlled." Rahul Bajaj, the Chairman of the National Task Force on Corporate Governance, appointed by the Confederation of Indian Industries (C.I.I.) said that it dealt with laws, practices and implicit rules that determine a company’s ability to take managerial decisions *vis-à-vis* its claimant in particular, its shareholders and the creditors, the state and employee in general. Various experts on the subject have opined that corporate governance is interplay between companies, shareholders, creditors, capital, markets and financial sectors, institutions and company law.

Although there are various attributes of corporate governance, yet some important rules and practice include the concentration of ownership and control and the constitution of boards and these role information to shareholders/ disclosure
2.2 Issues in Corporate Governance

Some of the issues regarding Corporate Governance are-

1. How independent does a Board of Directors needs to enforce accountability?

2. To whom should the management be accountable?

3. Who should be on the board?

4. How should investors go about enforcing accountability?

5. How should a company align the interest of all its employees to that of the company?

6. Are we relying too much upon rules to encourage good governance?

7. What does it mean by governing well?

The primary goal of the corporation is to maximize shareholders wealth in a legal and ethical manner.

The players involved in this game are -

1. Board of Directors

2. Various Committees

3. Management

4. Various outside stakeholders
   a. Shareholders
b. Employees  
c. Government  
d. Community  
e. Suppliers  

In the above model, Corporate Governance the internal stake holders and the external stakeholders are highlighted. In short we can define Corporate Governance as making the top management more accountable and responsive. For good Corporate Governance the integrity of the management is a must. The interest and time availability for the top management to address important issues and participate in strategic planning is critical. It is important that the functions, roles and responsibilities of board of directors, criteria for membership, selection of new members, succession planning be well defined. Communication is very important with the internal and external stakeholders through various modes i.e. 1. Website, 2 Quarterly Reports,3 through suggestions, meetings, discussions etc. Flow of information is a must. Information must be reliable, accurate and timely in nature.

Board of directors are responsible to prevent abuse of power, to ensure that proper books of accounts are maintained, to attend the various meetings, to form committees, and to evaluate the performance of board.

Corporate Governance is not a luxury but a necessity in today's globalized and liberalized environment. The company will succeed in the long run if it is trusted by the various stakeholders i.e. customers, employees, suppliers, shareholders, government, community etc. Fairness in transaction with all stakeholders is a must. It is all about building confidence and trust of stakeholders in the way it manages the affairs of the company.

Disclosures are a must. It is of two types - voluntary and mandatory. Mandatory disclosures are fixed by legal regulations from time to time. It is very important that the various stakeholders have equal access to the disclosed information.
Various disclosures required, in general, are

1. Resume of each director, directorship, and membership of other committees of board.
2. Terms of appointments, elements of compensation package of all directors.
3. Remuneration of senior officers just below directors.
4. Movement of stock prices in capital market where share prices are listed.
5. Summary of financial results as per accounting standards.
6. Movement of key personnel during the period.

Responsibility Towards Stakeholders

Employees have global opportunities and global aspirations. We will be able to retain the employees in our companies by treating them well, with courtesy and dignity and bring transparency in the dealings with them.

Customers, today, have a lot of choice. Only if the company has a high level of transparency and enjoys the confidence of the corporation, the customer will not do business on a long-term basis.

Government has reduced the corporate taxes and duties for the corporate. The government expects that the corporate lives up to the expectation and pays the taxes and duties. It will lead to government steps / policy decisions favoring the corporate world.

The corporate has the responsibility towards the society for creating employment, enlistments of locality, protecting lives of community at large, improving the quality of life within the vicinity of operation.
Suppliers should be assured of business, timely payment, and fair and non-discriminatory treatment. In return supplier should have 1. Sense of belongingness, 2. Regular supply, 3. Quality supply, 4. Fair pricing policy.

2.3 Corporate Governance Framework in India

2.3.1 Introduction

Corporate Governance was not a totally new concept in India. The Companies Act 1956 already had a set of provisions for assurance of good corporate governance. However the global debate on corporate governance inspired confederation of Indian Industries to evolve a voluntary code of conduct. Later on SEBI appointed a committee headed by Kumara Mangalam Birla to suggest measures for evolving new norms of corporate governance. The recommendations of Birla Committee were incorporated in the clause 49 of the listing agreement. At the same time the Companies (Amendment) Act, 2000 brought on the statute book the emerging concepts of the Audit committee, and its role, introduction of postal ballot, statement of directors’ report etc. Institute of Chartered Accountants of India also issued accounting standards relating to corporate governance practices.

2.3.2 C.I.I. Code of Conduct

The Confederation of Indian Industry has constituted a committee in 1956 under chairmanship of Mr. Omkar Goswami to prepare a draft report on corporate governance. The draft was duly considered by a twelve member task force headed by Mr. Rahul Bajaj, CEO, Bajaj Auto Ltd. The important features of C.I.I report on corporate governance charter are:

1. A single board which should meet at least six times a year, preferably at an interval of two months.
2. A listed company with a turnover of Rs. 100 crore and above should have professionally competent, independent non executive directors who should constitute at least 30% of the board if the chairman of the company is a non-executive and at least 50% of the board if the chairman and managing director is the same person.
3. No single person should hold directorship in more than 10 listed companies.

4. The non-executive directors should actively participate in the board with clearly defined responsibilities. They should know how to read balance sheet, profit and loss accounts, cash flow statements etc. They should have some knowledge of company law.

5. The company should pay a commission over and above the sitting fees to the non-executive directors.

6. Attendance record should be considered while reappointing directors.

7. The Board should be provided with following key information's.
   a. Annual operating plans and budgets.
   b. Capital manpower and overhead budgets
   c. Quarterly results of the company as a whole and its operating divisions,
   d. Internal audit reports,
   e. Various notices from revenue.
   f. Accidents, pollution problems etc.
   g. Default in payment of interest of non-payment or principal on any public deposit or secured creditors.
   h. Default in payment of any interoperates deposits.
   i. Any issue which involves possible public or product liability claims.
   j. Details of any joint venture or collaboration agreements.
   k. Transactions to involve substantial payment towards goodwill, brand equity etc.
   l. Recruitment or remuneration of senior officers below the board level.
   m. Labour problems and solutions.
   n. Quarterly details of foreign exchange exposure.

8. Listed companies with either a turnover over Rs.. 100 crore or paid up capital of Rs.20 crores should set up audit committee within two years. The audit committee should assist the board in accounting and reporting functions, should periodically interact with statutory auditors and internal auditors and discharge their fiduciary responsibilities with due diligence.
9. The listed companies should give data on:
   a. High and low monthly average of share prices in a major stock exchange and
   b. Greater details on business segments, up to 10% of turnover, sales revenue etc.
10. Major stock should insist on a compliance certificate signed by the CEO
11. Starting that the management is responsible for the preparation and integrity of the financial statements and other information on the annual reports, that is accounting policies confirm to standard practice and that the board has overseen the company's system to international accounting and administrative controls either directly or through the audit committee.
12. If any company goes to more than one credit rating agency it must divulge all the previous ratings.
13. Companies that default on fixed deposits should not be permitted to accept further deposits and make inter-corporate loans or investments or declare dividends until the default is made good.
14. Recommending for reducing the number of companies having nominee directors, CIT envisages that financial institutions should withdraw from company boards where their individual shareholding is less than 5% or the total Financial Institution holding is less than 10%.

2.3.3 Recommendation of Naresh Chandra Committee

The Department of Companies Affairs in the Ministry of Finance and company Affairs appointed a High Level Committee, popularly known as Naresh Chandra Committee, to examine various corporate governance issues and to recommend changes.

After a good deal of deliberations and inter-action with the trade associations and professional bodies, the Committee made very significant recommendations for changes, inter alia, in the Companies Act. They are:-

I. Disqualification for Audit Assignments
II. The following services shall not be provided by an audit firm to an audit
client Accounting and book keeping services relating to the accounting records or financial statements of the audit client; internal audit services.

III. Auditor's disclosure of contingent liabilities

IV. Auditors' Annual Certification of Independence

VI. Appointment of Auditors

VII. CEO and CFO Certification of Annual Audited Accounts

VIII. Auditing the Auditors.

IX. Independent Directors

X. Minimum Board Size of Listed Companies

XI. Teleconferencing and Video conferencing

XII. Audit Committee should consist exclusively of independent Directors

XIII. Remuneration of Non-executive Directors

XIV. Exempting Non-executive Directors from Certain Liabilities

XV. Training of independent Directors

XVI. Corporate Serious Fraud Office (CSFO)

2.3.4 Recommendation of N.R.Narayana Murthy Committee

SEBI constituted a Committee on Corporate Governance under the Chairmanship of Shri. N.R.Narayana Murthy. The Committee included representatives from the stock exchanges. Chambers of Commerce and industry, investor associations and professional bodies and debated on key issues and made recommendations as under:

The mandatory recommendations of the Committee are:

1. Audit Committee of Publicly Listed Companies should be required to review the following information mandatory.

2. Disclosure of Accounting Treatment

3. Audit Qualifications

4. Basis for Related Party transactions

5. Risk management - Board Disclosure
6. Training of Board Members  
7. Use of Proceeds of IPO  
8. Written Code of Conduct for Executive Management  
9. Nominee Directors - Exclusion of nominee directors from the definition of independent directors  
10. Non-executive directors Compensation - Limits on compensation paid to independent directors  
11. Independent Directors – Definition  
12. Internal Policy on access to Audit Committee  
13. Whistle Blower Policy  
14. Subsidiary Companies - Audit committee requirements  

2.3.5. Birla Committee Report  

The mandatory recommendations of the Kumar Mangalam Committee included the constitution of Audit Committee and remuneration Committee in all listed companies, appointment of one or more independent director on them, recognition of the leadership role of the chairman of the company, enforcement of Accounting standards, the obligation to make more disclosures in annual financial reports, effective use of the power and influence of institutional shareholders and so on. The committee also recommended a few provisions which are non mandatory. In short the recommendations are as follows:  

1. The Board of company should have an optimum combination of executive and non-executive directors with not less than 50 percent of the Board comprising
the non-executive directors.

2. The Board of company should set-up a qualified and an Independent Audit committee.

3. The Audit committee should have minimum three members, all being non-executive directors, with the majority being independent and with at least one director having financial and accounting knowledge.

4. The chairman of the Audit Committee should be an independent director.

5. The board of directors is a combination of executive directors and non-executive directors.

6. The non-executive directors comprise of promoter directors and independent directors. Independent directors are those who, apart from receiving directors, remuneration, do not have any material pecuniary relationship or transactions with the company, its promoters, its management or its subsidiaries that in the judgment of the Board may affect their independence of judgment.

7. The chairman of Audit Committee should be present for the Annual General Meeting to answer shareholder queries.

8. The Company Secretary should act as secretary to the audit Committee.

9. The Audit committee should meet at least thrice a year. The quorum should be either two members or one third of the members of the Audit committee.

10. The Audit committee should have powers to investigate any Activity within its terms of reference, to seek information from any employee, to obtain outside legal or professional advice and to secure attendance of outsiders if necessary.

11. The Audit Committee should discharge various roles such as reviewing any change in accounting policies and practices, compliance with Accounting standards, compliance with Stock Exchange and legal requirements concerning financial statements; the adequacy of internal control systems; the company's financial and risk management policies. etc.

12. The Board of directors should decide the remuneration of the non-Executive directors.

13. Full disclosure should be made to the shareholders regarding the remuneration package of all directors.
14. The Board Meeting should be held at least 4 times in a year.
15. A director should not be a member in more than ten committees or act as the chairman of more than five committees across all companies in which he is a director. This is done to ensure that the members of the Board give due importance and commitment of the meeting of the Board and its committees.
16. The management must make disclosures to the Board relating to all material, financial and commercial transactions, where they have Personal interest.
17. In case of appointment of a new director, re-appointment of a director, the shareholders must be provided with a brief resume of the director, his expertise, and the names of companies in which the person also holds directorship and the membership of committees of Board.
18. A Board Committee must be formed to look into the redressal of shareholders complaints like transfer of shares, non-receipt of balance sheet, dividend etc.
19. There should be a separate section on Corporate Governance in the annual reports of the companies with a detailed compliance report.

Apart from these, the Kumar Mangalam Birla Committee also made some recommendations that are non-mandatory in nature. Some of the non-mandatory recommendations are as follows:

1. The Board should set-up a remuneration committee to determine the company’s policy on specific remuneration packages for executive directors.
2. Half yearly declaration of financial performance including summary of the significant events in the last six months should be sent to each shareholder.
3. Non-executive chairman should be entitled to maintain a chairman's office at the company's expense. This will enable him to discharge the responsibilities effectively.

It is interesting to note that Kumar Manglam Birla Committee while drafting its recommendations was faced with the dilemma of statutory v/s voluntary compliance. The desirable code of Corporate Governance, which was drafted by CII and was voluntary in nature, did not produce the expected improvement in Corporate Governance. It is in this context that the Kumar Mangalam committee felt that under the Indian conditions a statutory rather than a voluntary code would be a more purposive and meaningful. This
led the committee to decide between mandatory and non-mandatory provisions. The committee felt that some of the recommendations are absolutely essential for the framework of corporate governance and virtually from its code while other could be considered as desirable, besides some of the recommendation needed change of statute, such as the companies Act for their enforcement. Faced with this difficulty the committee settled for two classes of recommendations.

2.3.6 Reports And Recommendations For Effective Corporate Governance:

Introduction

By its circular SEBI/MRD/SE/31/2003/26/08 date August 26, 2003, issued in exercise of powers conferred by section 11(1) of the SEBI Act, 1992 read with section 10 of the Securities Contracts (Regulation) Act 1956, SEBI has revised clause 49 of the Listing agreement. All Stock Exchanges have been directed to immediately replace the existing Clause 49 of the listing agreement by the revised Clause 49.

The schedule of implementation of the new Clause 49 is as follows:

(i) By all entities seeking listing for the first time, at the time of listing.
(ii) By all companies which were required to comply with the erstwhile Clause 49 i.e. all listed entities having a paid up share capital of Rs 3 crores and above or net worth of Rs 25 crores of more at any time in the history of the entity. These entities shall be required to comply with the requirement of this clause 49 on or before March 31, 2004.

Though throughout the text of Clause 49, the terms 'company' and ‘entity’ have been interchangeably used, the requirements of Clause 49 are applicable to the
listed companies incorporated under companies. Act 1956 and other bodies corporate, which not companies but which have their securities listed on Stock exchanges.

Clause 49 applies to all listed companies and other corporate bodies, but it does not apply to unlisted companies / corporate bodies. There are, however, some requirements that have been sought to be made applicable to unlisted companies, e.g. subsidiaries of listed company that are not listed companies. It is unclear how when a Stock Exchange and a company does not have the Listing agreement entered into between them as a binding covenant, its requirements will be applicable to them. Perhaps, it may be argued that the obligation to get such requirements complied with by an unlisted company will be on the listed company.

All requirements of clause 49 are mandatory except, those given in Annexure 10, called "non-mandatory requirements", which may be implemented by a company at its discretion. However, the disclosures of the adoption/non-adoption of the non-mandatory requirements shall be made in the section on corporate governance of the annual report.

One feature of the new clause 49 is that some of its provisions conflict with the provisions of Companies Act 1956 by which the companies are governed. Several provisions indicate lack of cognizance of the terms and expressions that are used in legal drafting and those defined in Companies Act 1956.

What follows is a detailed commentary on the new clause 49.

**Sub Clause 1(A) of Clause 49**

1. Sub-clause 1A of Clause 49 seeks to set up the composition of the board, which every listed company must have and must always maintain. All existing listed companies will have reconstitute their boards, if necessary, by March 31, 2004. While companies seeking listing after August 26, 2003. must have the stipulated composition of their boards from the date of listing.
2. The board must have two types of directors: (1) executive; and (2) non-executive. In terms of Companies Act 1956, the expression "executive director" means managing director or whole-time director and the expression "non-executive" means those directors who do not hold either of those two offices. However, according to Sub-clause 49, the directors will have to be classified into three categories. (1) executive directors; (2) non-executive directors who are independent directors; (3) non-executive directors who are not independent directors.

3. Sub-Clause IA(i) provides an aid to determine whether a director is an independent director, or not. At a general rule, all executive directors are non-independent directors and all non-executive directors are independent directors. In other words, these are the disqualifications for being considered as an independent director. However, to be qualified as an independent director, one must not fall in any of the criteria specified in items (a) to (f).

4. According to item 'a', a person will be disqualified from being treated as an independent director if he has any material pecuniary relationships or transactions with- (a) the company; (b) its promoters; (c) its senior management; (d) its holding company; (e) its subsidiaries; or (f) its associated companies.

a. The use of the word "material" in the phrase "material pecuniary relationships or transactions" indicates that only those relationships or transactions which involve high monetary advantage or profit to the concerned person will fall in the purview of this criterion, but in practice the difficulty will arise as to the determination of what is material and what is not. Hence, it would be desirable if some benchmark in terms of percentage of turnover of the company is fixed (say 5%).
5. Pecuniary means, relating to or connected with money, or monetary. Thus, a relationship or transaction that does not involve any monetary advantage or profit or which cannot be measured in money terms will not disqualify a person from being treated as an independent director. No pecuniary relationship or transaction which a relative or an associate or a person has with any of the above mentioned parties will not disqualify that person, although as a good corporate governance practice, a close relative's or associate's relationship or transaction should be considered as a disqualification.

6. Relationship or transaction with the "senior management" is an absurd expression; "senior management" is neither a natural person nor an artificial person having an independent entity and it is not a term that can have a hard and fast unambiguous meaning.

7. The expression "apart from receiving director's remuneration: indicates that remuneration received by a director as director does not make him non-independent director; e.g. commission or sitting fees.

8. According to item 'b', a person who is related to promoters or management of the company at the board level or at one level below the board, will be disqualified for being appointed as an independent director. Here again the expression "related to management" is absurd. Moreover, if a promoter is a body corporate, in that body corporate is unclear.

9. Both items 'a' and 'b' use the term "promoter", but it is not defined in Clause 49. This term has been defined in Rgl. 2 (1)(h) of the SEBI (Substantial Acquisition of Shares and Takeover Regulations) 1997 and in Para 6.24.2 of the SEBI disclosure and Investor Protection guidelines 2000. These two definitions are not identical. However, out of these definitions, which would apply here, is not specified. In absence of any such specification, the general rule of interpretation should apply, namely 'literal interpretation' or 'dictionary meaning', but if this rule is applied, then matter would be further confounded.
Hence, the pivot of the above mentioned definitions, i.e. controlling interest, should be taken to determine as to who the promoters of the company are. It is, however, advantageous to clarify as to which of these definitions would apply here.

10. In item 'b', the phrase "related to promoters or management" is absurd. An individual related to a promoter which is a body corporate or an individual related to the management (meaning the board of directors as a whole) is unheard of. The word "relative" is always used in relation to human beings. It should be applied in relation to individuals only, unless by an artificial definition two artificial persons (e.g. companies) are declared to 'related persons', such a holding and its subsidiary or two companies under the same management or in the same group. However, whether the definition given in the companies Act 1956 will apply or not is unclear.

11. Item 'c' disqualifies a person who has been an executive of the company in the immediately preceding three financial years. Here also the term "executive" is a vague and ambiguous term; it is not a term defined or having a fixed meaning. It needs to be defined.

12. Under item 'd', a person is disqualified if he is a partner or an executive of the statutory audit firm or the internal audit firm that is associated with the company, and has not been a partner or an executive of any such firm for the last three years. This will also apply to legal firm(s) and consulting firm(s) that have a material association with the entity.

13. In item’d’, the terms "executive", "consulting firm" and "material association" are ambiguous. Any entity (whether a Juristic person or not) seems to be covered by the phrase "consulting firm". Every consulting firm, whether legal, financial, taxation, management, business, etc, would be covered. Why the disqualified specified in item d has been made applicable only to the auditors who are partners or executives of firms, and why it has not been made applicable to those auditors who operate as sole proprietors, is unclear.
14. According to item 'e', to be qualified as an independent director, the concerned person should not be a supplier, service provider or customer of the company, regardless of the value of the goods sold, purchased or services provided, and regardless of compliance with the provisions of Sections 297, 299 and 300 of Companies Act 1956. Every supplier, customer or service provider of the company will get disqualified. Thus, even a person having with the company a dealing of an insignificant value also will get disqualified and also a person buying any of the company's products in retail shop. So if one uses soap or detergent, or toothpaste, or a bulb, or a vehicle, or a medicine, of a company, he cannot be appointed as an independent director of that company. Not only that, a person buying a company's product as a customer in the retail shop or availing of service from its agent also will be debarred.

According to the Explanation to this sub-clause, institutional directors shall be considered as independent directors whether the institution is an investing institution or a lending institution. The term "Institution" seems to have been used to refer to only those institutions which are public financial institutions (created by either an Act of Parliament or Incorporated as companies under the Companies Act 1956). This uncertainty could have been easily set at rest by using the expression "Public Financial Institution" as defined in Section 4A of the Companies Act 1956.

Sub Clause 1(B) Of Clause 49

1. The requirement under item 'i', that "All compensation paid to non-executive directors shall be fixed by board of Directors and shall be approved by shareholders in general meeting", is virtually identical with the provisions of Section 309 of Companies Act 1956. However if the articles of association of company provides differently, the company must comply with this requirement. "Compensation" is not the correct term in the context in which it is used. Generally, the term "compensation" is used to denote monetary payment to compensate for loss or damage; or damages awarded by a court or other
authority. The preferred term is "remuneration".

2. The phrase "compensation philosophy" means policy of the company as regards directors' remuneration. The information required to be published the annual report may be included in the report of Corporate Governance Code.

3. What is precisely contemplated by "The considerations as regards compensation" is not clear.

4. The phrase "their notice of appointment" probably means the notice of the general meeting at which a resolution seeking approval of the company to the payment of remuneration.

Sub-Clause I(C) Of Clause 49

1. This whole sub-clause is confusing. Firstly, which of the independent directors should review legal compliance reports is not clear. Perhaps, the phrase "a committee comprising independent directors" should have been used. Secondly, what "legal compliance reports prepared by the company" is contemplated is not clear, because there is no obligation on the companies, either under Listing Agreement or Companies Act 1956 or any other law to prepare and produce to any body or authority a legal compliance report, although some companies do that voluntarily. Where and how frequently independent director will review these reports may be decided by the board. For any such review, the presence of executive directors as well other executives of the company will be useful, rather essential.

2. The stipulation that "In the event of any proceedings against an Independent director in connection with the affairs of the company, defense shall not be permitted on the ground that the independent director was unaware of this responsibility, may not stand the test of law if the statute under which action is taken permits such defense and the court will be bound to take cognizance of such dele-nee, if put forth by a directors. For example, Section 633 does permit such defense, and, if proved, the concerned may be relived by the court. Who shall not permit the so-called defense, whether SEBI, stock exchange or a court, is an obscurity. Interestingly, an independent director is
prohibited from resorting to such defiance, but executive director is not. The phrase this responsibility seems to have been used to refer to "review legal compliance reports” as well as steps taken by the company to cure any taint.

3. These sub-clause uses the term "remuneration" as opposed to the term "compensation" used in the previous sub-clause. Whether this difference is deliberate or unintentional is not clear.

**Sub - Clause J(D) of Clause 49**

1. According to item (i), every listed company must hold at least four meetings of its board of directors in a year and there should not be an interval of longer than four months between two consecutive board meetings.

2. According to item 'ii', no director of a listed company shall at a time be a member of more than ten committees of directors and chairman of more than five committees of directors. These restrictions will apply only to membership and chairmanship of committees, but it applies lo all directors, executive directors, non-executive directors and independent directors.

The memberships and chairmanships held in public companies only will be taken into account for the purpose of the limit on the number. This restriction will apply to only three types of committees specified in the explanation. Every director must monitor the number and inform the company about the Committee positions the occupies in other companies and notify changes as and when they take place.

**Sub - Clause I(E) of Clause 49**

1. What should the Code of Conduct provide for or what does and don'ts it should lay down and whether it is a code of best practice suggested by the Cadbury Committee or anything else, is not stated. It would be desirable to provide a Model Code, which the companies may adopt with necessary modifications. Item 'ii' provides for a sort of self-certification of
compliance with the Code of Conduct.

2. CEO (Chief Executive Officer) is the person who has overall responsibility for the management of that company. In India, the managing director is the CEO. If a company has appointed the manager as defined in Section 2(24), he will be the CEO. Section 269 of Companies Act 1956 requires every company having a paid-up share capital of Rs. 5 crores or more to appointment either a managing director or a whole-time director or the manager. CEO (Chief Executive Officer) appears to have been used to refer to the director or officer who holds the office of either managing director or whole-time director or the manager in terms of the provisions of the Companies Act 1956.

3. COO means Chief Operating Officer, which is prevalent in a very few Indian companies. If a company does not have COO, the report need not carry anybody's signature in lieu of COO's.

Sub – Clauses I(F) Of Clause 49

1. To paraphrase this sub-clause, what it really means is deal a non-executive director shall not hold office at a time for a term exceeding three years at a time and no non-executive director shall be capable being re-appointed as director of a company in which he has been a non-executive director for consecutive period of nine years. Thus the tenure of a non-executive director has been limited to successive nine years at a time in a company, and on expiration of the nine years, a non-executive director in that company. All existing listed companies will have to comply with this requirement with effect from 31 March 2004. consequently, all existing non-executive directors who have served for a continuous period of nine years of more will have to step down. The phrase "running continuously" occurring at the end seems to be qualifying the phrase "nine years in three terms of three years each". Accordingly, a non executive director who has not completed in office continuous nine years may be re-appointed if there is an interval between the previous term and new term.
2. The stipulation of maximum tenure of three years at a time may sometimes create difficulties in view of the provisions of Sections 255 and 256 of Companies Act 1956 regarding rotational retirement of directors.

Sub-Clause II(A) of Clause 49

1. This sub-clause will apply to all listed companies, besides the provisions of Section 292A of Companies Act 1956. How an inconsistency between the two will be resolved is unclear. Going by the general rule of interpretation, in case of conflict the statutory provision would prevail over the listing agreement.

2. None of the members of the audit committee should be managing or whole-time director. Moreover, a majority of the members should be independent directors. This condition shall apply regardless of the number of members of the Committee whether three or more than three.

3. The chairperson of the committee must be an independent director. In absence a specific provision as to how the chairman shall be appointed. It would be within the competence of the board of directors to nominate one of the members of the company as the chairman and fix his/her term.

4. The audit committee is committee of directors. No person who is not a director can be appointed as a member of audit committee. Though no executive director can be a member of the audit committee, there is no bar to request such a director to attend meetings as invitee; on many occasions their presence will help the committee.

5. All members of audit committee are required to be "financially literate" and at least one member shall have accounting or related financial management expertise. Ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows, is the yardstick of financial literacy. It means ability to read, understand and analyse the financial statements. As to whether a member has accounting or related financial management expertise or not, can be ascertained from the resume of a member.

Sub – Clause III (A) of Clause 49

1. The minimum number of meetings (three in a year) should be held in such a way that one meeting shall be held before the finalization of annual accounts
and one every six months. Interval between the meeting held before the finalization of annual accounts and the to be held ones in six months is immaterial. The phrase "finalization of annual accounts" refers to the approval of annual accounts by the board of directors as required under Section 215 of Companies Act 1956.

2. The audit committee must comprise at least two directors both of who should be independent directors. Thus, no executive director and no non-executive director who is not independent director should be a member of the audit committee.

3. The minimum prescribed quorum for the meetings of the audit committee is two members or one third of the members of the committee, whichever is higher. The board may however fix a higher quorum. The board may also make rules do deal with the situation of absence of quorum, adjournment of meetings, etc.

Sub-Clause III (A) Of Clause 49

Sub-section (3A) of section 211 of Companies Act 1956 provides that, every profit and loss account and balance sheet of the company shall comply with the accounting standards, and its sub-section (3B) provides that where the profit and loss account and the balance sheet of the company do not comply with the accounting standards, such companies shall disclose in its profit and loss account and balance sheet, (the following, namely;- (a) the deviation from the accounting standard (b) the reasons for such deviation; and (c) the financial effect, if any, arising due to such deviation.

Sub-Clause IV (A) of Clause 49

1. The phrase "whistle-blower" (used especially in newspapers) means a person who informs people in authority or the public that the company they work for is doing something wrong or illegal. In the context of its use of this phrase here, it means that employees of the company shall be made available access to the Audit Committee to report to it an unethical or improper practice (not necessarily only a violation of law) in the company, without first informing their supervisors.
2. Every listed company shall take measures to ensure that this right of access is communicated to all employees by means of internal circulars, etc. The employment and other personnel policies of the company shall contain provisions protecting "whistle blowers" from unfair termination and other unfair prejudicial employment practices.

3. Item 'III' requires a company annually to affirm that it has not denied any personnel access to the Audit Committee of the company (in respect of matters involving alleged misconduct) and that it has provided protection to "whistle blowers" from unfair termination and other unfair or prejudicial employment practice. Such affirmation shall form a part of the board's report on corporate governance that is required to be prepared and submitted together with the annual report, i.e. the corporate governance report to be included in the annual report.

4. Item 'IV' provides that the appointment, removal and terms of remuneration of the chief internal auditor shall be subject to review by the Audit Committee. The term "review" means appraisals or evaluation; an examination of some decision taken, with) the intention of changing it if necessary. It is thus clear from these definitions that, the AC shall have the right to reconsider the decision taken by an executive or a committee of directors or executives for the appointment, re-appointment, removal and remuneration of an internal auditor of the company. The proper way to handle these matters would be for an executive or managing or other executive director to make a proposal and refer it to the Audit Committee for its views and recommendations.

Sub - Clause (V) of Clause 49

1. According to item ‘I’, the provisions of Clause 49 of Listing Agreement, relating to the composition of the board of the holding - company shall be made applicable to the composition of the board of subsidiary companies. At
least one independent director on the board of the holding company must be a
director of the subsidiary company. The rest of the directors may be any person
so however that the composition of the board conforms to Para I (a).

2. The holding company's audit committee must review the financial statements, in
particular the investments made by the subsidiary company. The phrase
"financial statements" seems to have been used to refer to annual accounts and
reports of the subsidiary company.

3. Item 'iv' requires the minutes of the board meeting of the subsidiary, to be
placed for review at the board meeting of the holding company. It is a review
and not merely confirmation, ratification or noting of a decision taken by the
subsidiary's board that is contemplated. What is contemplated is that the
holding company's board must review and either confirm or change the
decision taken by the subsidiary's board and issue appropriate directions or
instructions to the subsidiary's board, which will be binding on that board.

All these provisions will apply even though a subsidiary is an unlisted company. This is
in excess of the jurisdiction of the stock exchange.

Sub-Clause VI(A) of Clause 49

An important aspect of this sub-clause is the requirement that management shall
provide a clear description in plain English of each material contingent liability and
its risks. The Plain English guide of the Plain English Campaign, UK, explains the
meaning of "plain English" as "not decorated or complicated, simple; not fancy; to
say or write something in plain English means to say simply and clearly expressed,
without using technical or abstruse words".

Sub-Clause VI (A) Of Clause 49

1. This sub-clause does not spell out as to who will be considered related parties.
   Accounting Standard on Related Party Disclosures (AS 18) issued by the
   Institute of Chartered Accountants of India defines "related party
relationships", which may be taken as the basis for compliance with this sub-clause.

2. The basis of transactions with related parties means the considerations or factors that weighed with the management of the company in entering into dealings with the related party vis-a-vis other parties engaged in similar business, such as price, quality, payment terms, size of dealings, quality, confidentially, criticality of the products/services from health, pollution viewpoint, uninterrupted supply, etc.

3. If any transaction is not on an arm's length basis, management shall provide an explanation to Audit Committee justifying the same.

4. A statement of all transactions with related parties is required to be placed before the Audit Committee for formal approval/ratification. This does not mean that a prior approval or sanction of the Audit committee is necessary. A post facto approval or ratification will be enough. It would be sufficient compliance if it is placed on quarterly, half-yearly or yearly basis.

**Sub-Clause VI (B) of Clause 49**

Risk is a potential source of loss; the possibility of suffering some form of loss or damage. Risk management involves handling likely harm to an organization, in the most appropriate manner. Under this sub-clause, every listed company must have a system to inform the board about the risk assessment and minimization procedures. Such a system should be periodically reviewed to ensure that the company management has been taking measures to minimize and control. The management shall place before the board every quarter a report certified by the compliance officer of the company, detailing and accompanied by related documents the business risks faced by the company, measures to address and minimize such risks, and any limitations to the risk taking capacity of the corporation. The board has to approve this report.
Sub-Clause VI(C) Of Clause 49

This requirement applies to only Initial Public Offerings. This requirement is in addition to that under Clause 43 of Listing Agreement, according to which every listed company must furnish to the stock exchange on a half-yearly basis, a statement of information relating to utilization of funds raised by a public issue or rights issue of securities and to disclose in the board's report under Section 217 of Companies Act 1956 a statement of variation between projected utilization and actual utilization of funds.

Sub-Clause VI (D) Of Clause 49

1. Though the caption of this sub-clause is "Remuneration of Directors", it actually covers two components: (1) All pecuniary relationship or transactions of the non-executive director's vis-à-vis the company; and (2) details of remuneration of non-executive directors broken up in the stated manner.

2. This sub-clause applies to only non-executive directors' remuneration. There seems to be an anomaly in this sub-clause. If it applies in respect of only non-executive directors, there cannot be the different kinds of components of remuneration as mentioned at 'a', 'b' and 'c' of item 'ii', in as much as under Companies Act 1956. No non-executive directors are paid that kind of remuneration, except in rare cases with the approval of the Central Government under Section 309(4) of Companies Act 1956. These directors are generally remunerated by commission on net profit and fees for attending board meetings (and a few cases by paying remuneration for services of professional nature under the proviso to sub-Section (1) of that section).

Sub Clause VI (E) of Clause 49

This sub-clause requires, as part of the directors' report or as an addition there to, a Management Discussion and Analysis Report which must include discussion on the specified mailers within limits set by the company’s competitive position.
Sub-Clause VI (F) of Clause 49

1. The requirement under item (i) of this sub-clause applies to the appointment and re-appointments of all directors, executive as well as non-executive, at general meetings of a company, but it would not apply to the appointments of directors by the board, such as additional director, alternate director or a director appointed to fill a casual vacancy.

2. The specified particulars of the appointee may be disclosed in the explanatory statement annexed to the notice of a general meeting as required under Section 173 of Companies Act 1956, which contains an item of appointment / re-appointment of a director.

3. Item (iii) requires constitution of a committee of directors under the chairmanship of a non-executive director, to be called Shareholders/Investors Grievance committee, to deal with shareholders and investors' complaints like transfer of shares, non-receipt of balance sheet, non-receipt of declared dividends, etc., and redressed thereof. The term "investor" in addition to "shareholder" seems to have been employed to refer to other security holders (e.g. debenture holders, bond holders, etc).

The term "shareholder", though not appropriate, cannot be construed in a restrictive sense, namely one who holds shares in a company but who is not member of the company, because his name has not been entered in the register of members of the company. The expressions "member", "shareholder" and "the holder of a share" are used in Companies Act 1956 in the same sense, meaning persons holding shares in a company and registered as such in the register of members of the company. According to item (iv), in order to expedite the process of share transfers the board is required to delegate the power of approval of share transfer to an officer or a committee or to the registrar and share transfer agents, and the delegate is required to attend to share transfer formalities at least once in a fortnight. The Companies Act 1956 is silent as to who should approve the transfers. The various provisions of the Act, however, go to reveal that it is the prerogative of the board to approve or refuse the transfers, but if the articles of the
company empower the board to delegate its powers to directors or other officers of the company, the board may, by a resolution, delegate its power of approval of share transfers even to the company's officers who are not directors, subject to such restrictions, limitations and conditions as the board may think proper.

**Sub-Clause VII of Clause 49**

1. To whom this certificate will be produced and who will approve it and where it will be disclosed, nothing is specified in this sub-clause.

2. The certification required under this sub-clause is a needless formality. There are already many provisions of certification and signing of annual accounts, there is no need for one more certification; no useful purpose would be served by this certification.

3. Review of directors' report by the (CEO / CFO) is an incongruous requirement. Section 217 requires the whole board to approve the directors' report and authorize: its signing on behalf of the board. This, for the correctness of the information given in the directors' report the whole board is responsible under the law. Review of the statement by the CEO/CFO is inappropriate.

**Sub-Clause IX of Clause 49**

1. Every annual report of a listed company must contain a Corporate Governance Compliance Report (CGCR). The phrase "annual report" is not a defined expression. It refers to the annual accounts and directors' report of a company, issued to the members of a company and placed before annual general meeting for adoption and then filed with the Registrar of Companies, in accordance with the provisions of Companies, Act 1956. Annual report is a set of various documents attached or annexed to a balance sheet and profit and loss - account. The CGCR may be placed anywhere in the annual report.

2. The CGCR is a detailed report on the compliance with the requirements of Clause 49 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. The report must be in conformity with the list of items in Annexure-1 B to Clause 49. A list of non-mandatory requirements is given in Annexure -1C.

3. Apart from the annual report stated above, every listed company must also submit a quarterly compliance report in the prescribed format to every stock exchange at which the company's securities are listed, within 15 days from the close of quarter. The report shall be submitted (meaning signed) either by the Compliance office of the CEO.

Sub Clauses X of Clauses 49

The certificate required is only in respect of the annual corporate governance compliance report. The certification may be obtained either from the company's auditors or a practicing company secretary. No form of the certificate has been prescribed.

2.3.7 Three C Effect In Banking

As the Indian economy looks to increase more into the global economy, the banking industry looks to keep pace. The 3 key strategic elements in banking today are:

1. Capital
2. Consolidation
3. Corporate Governance

2.3.7.1 Capital

The need for additional capital is required by banks to increase competitiveness. As per the survey conducted by FICCI about 84% respondents feel Indian banks require fresh issuance of capital to enable banks to support large business
assets, clean up balance sheets, cushion against shock and also being compliant with future and current regulatory requirements.

i) Retail and Corporate credit growth in the near future is expected to be strong with the improvement in economy.

ii) Many leading banks are focusing to build their presence and operations in international, marketing so capital is required.

iii) Banks adopting approach for high-risk appetite have to keep more capital apart of unexpected losses. Migration lo Based II will require stringent and higher capital adequacy norms and allocation of capital towards marketing and operational risk in addition to credit risk. Banks are required to give a roadmap by Dec. 2004 to migrate to Baeel II.

iv) Minimum capital threshold in private banks is increased from 200 crores to 300 crores. The foreign banks operating in India as 100% subsidiary or new private bank have to comply with this. Around 14 banks are likely to approach. The classification on shareholding cap, 10% voting right cap etc. will give impetus to this process.

2.3.7.2 **Consolidation**

Indian banks are not well represented on list of global banks. Consolidation is necessary to enable banks to compete on scale and grow at national and international level.

The consolidation of Punjab National Bank with Nedugandi Bank, OBC with GTB is government driven while ICICI Bank with Madura Bank, HDFC Bank with Times Bank is market driven. The consolidation must lead to synergies and increase in capabilities.

2.3.7.3 **Corporate Governance**

It is important for the banks to collate and share information that address the varied information needs of different internal (B.O.I) and external (R.B.I., analyst, customer, investor) stakeholder needs. Some banks have adopted measures in this regard.
As the bank look overseas, apart from the need for capital, there is a need to build appropriate process and systems that meet international standards on risk management, anti money laundering, transparent financial reporting.

In order to meet the needs and ensure greater governance and transparency of its operations, the banks should answer the following questions -

1. How is the bank organized and run?
2. What is the financial health of bank?
3. What are the risk faced by bank in its operations and how does it overcome its.

The information required is accurate relevant and available in user friendly manner. Banks will have to understood information needs. It will also need to focus on building awareness and educate the stake holders on interpreting the information to assist them to understand the banks operations and performance better.
2.4 History of Banking in India

Without a sound and effective banking system in India it cannot have a healthy economy. The banking system of India should not only be hassle free but it should be able to meet new challenges posed by the technology and any other external and internal factors.

For the past three decades India’s banking system has several outstanding achievements to its credit. The most striking is its extensive reach. It is no longer confined to only metropolitans or cosmopolitans in India. In fact, Indian banking system has reached even to the remote corners of the country. This is one of the main reason of India’s growth process.

The government’s regular policy for Indian bank since 1969 has paid rich dividends with the nationalization of 14 major private banks of India.

Not long ago, an account holder had to wait for hours at the bank counters for getting a draft or for withdrawing his own money. Today, he has a choice. Gone are days when the most efficient bank transferred money from one branch to other in two days. Now it is simple as instant messaging or dial pizza. Money have become the order of the day.

The first bank in India, though conservative, was established in 1786. From 1786 till today, the journey of Indian Banking System can be segregated into three distinct phases. They are as mentioned below:

I. Easy phase from 1786 to 1969 of Indian Banks
   II. Nationalization of Indian Banks and up to 1991 prior to Indian banking sector Reforms.
   III. New phase of Indian Banking System with the advent of Indian Financial & Banking Sector Reforms after 1991.

To make this write-up more explanatory, I prefix the scenario as Phase I, Phase II and Phase III

Phase I
The General Bank of India was set up in the year 1786. Next came Bank of Hindustan and Bengal Bank. The East India Company established Bank of Bengal (1809), Bank of Bombay (1840) and Bank of Madras (1843) as independent units and called it presidency Banks. These three banks were amalgamated in 1920 and Imperial Bank of India was established which started as private shareholders bank, mostly European shareholders.

In 1865 Allahabad Bank was established and first time exclusively by Indian, Punjab National Bank Ltd. was set up in 1894 with headquarters at Lahore. Between 1906 and 1913, Bank of India, Central Bank of India, Bank of Baroda, Canara Bank, Indian Bank, and Bank of Mysore were set up. Reserve Bank of India came in 1935.

During the first phase the growth was very slow and banks also experienced periodic failures between 1913 and 1948. There were approximately 1100 Banks. Mostly small. To streamline the functioning and activities of commercial banks, the Government of India came up with the Banking Companies Act, 1949 which later changed to Banking Regulation Act 1949 as per amending Act of 1965 (Act No.23 of 1965). Reserve Bank of India vested with extensive powers for the supervision of Banking in India as the Central Banking Authority.

During those day’s public has lesser confidence in the banks. As an aftermath deposit mobilization was slow. Abreast of it the saving bank facility provided by the Postal department was comparatively safer. Moreover, funds were largely given to traders.

Phase II

Government took major steps in this Indian Banking Sector Reform after independence. In 1955, it nationalized Imperial Bank of India with extensive facilities on a large scale specially in rural and semi-urban areas. It formed State Bank of India to act as the principal agent of RBI and to handle banking transaction of the union and State Government all over the country.

Seven Banks forming subsidiary of State Bank of India was nationalized in 1960 on 19th July 1969, major process of nationalization was carried out. It was effort of the then Prime Minister of India, Mrs. Indira Gandhi. 14 major commercial banks in the country were nationalized.
Second phase of nationalization India Banking Sector Reform was carried out in 1980 with seven more banks. This step brought 80% of the banking segment in India under Government ownership.

The following are the steps taken by the Government of India to Regulate Banking Institutions in the country:

1949 : Establishment of Banking Regulation Act.

1955 : Nationalization Of State Bank of India.

1959 : Nationalization of SBI subsidiaries.

1961 : Insurance cover extended to deposits.

1969 : Nationalization of 14 major banks.

1971 : Creation of Credit Guarantee corporation.

1975 : Creation of regional rural banks.

1980 : Nationalization of seven banks with deposits over 200 crore.

After the nationalization of banks, the branches of the public sector bank India rose to approximately 800% in deposits and advances took a huge jump by 11,000%

Banking in the sunshine of Government ownership gave the public implicit faith and immense confidence about the sustainability of these institutions.

Phase III

This phase has introduced many more products and facilities in the banking sector in its reforms measure. In 1991, under the chairmanship of M Narsimham, a committee was set up by his name, which worked for the liberalization of banking practices.

The country is flooded with foreign banks and their ATM stations. Efforts are being put to give a satisfactory service to customers. Phone banking and net banking introduced. The entire system became more convenient and swift. Time is given more importance than money.
The financial system of India has shown a great deal of resilience. It is sheltered from any crisis triggered by any external macroeconomics shock as other East Asian Countries suffered. This is all due to a flexible exchange rate regime, the foreign reserves are high, the capital account is not yet fully convertible, and banks and their customers have limited foreign exchange exposure.