CHAPTER III

CORPORATE GOVERNANCE IN INDIA

With the growth of corporate form of organisation, management and ownership have been considerably distanced from each other. A number of company failures have been reported and several instances of mismanagement have been alleged, with some well known and senior corporate executives being hauled up for non-performance and non-compliance with the country’s legal requirements. In all such instances common investors have lost out, either through repayment defaults or by erosion of market value of their holdings.

Many of the developing countries including India have moved in varying degrees in the direction of an open market driven economy, which is an essential ingredient of capitalist societies. Globalisation of markets calls for a correspondingly improving compliance with global practices in all spheres of corporate activity. An apparent linkage exists between a company’s governance standards and its market value. Shareholder activism is driving more and more companies towards better governance.

Corporate governance is a part of corporate ethics and value system. The term corporate governance has emerged on the Indian scenario recently. Only during the last few years, the need for improvement in governance is attracting the attention of Indian industries. Good corporate governance is the key to ensure that the competitiveness of the Indian industry is maintained and further strengthened.
This chapter presents a brief summary of reports of various committees on corporate governance. A comparative summary of the recommendations of all the committees on corporate governance is also presented at the end of this chapter. Based on the discussion in this chapter a code of governance which is most appropriate for Indian Corporate sector was developed by the researcher and has been presented in chapter VI. The reports of the following committees have been examined in this chapter.

1. Cadbury committee.
2. Greenbury committee.
4. World bank.
5. Confederation of Indian Industry.
6. The Associated Chambers of Commerce and Industry of India and

3.1 REPORT OF THE CADBURY COMMITTEE

The Cadbury Committee was set up in May 1991 by the Financial Reporting Council of the London Stock Exchange to look into the financial aspects of corporate governance. The move to set up the Committee was taken to improve the standards of financial reporting and to arrest any likely damage to

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London's reputation as a financial centre and reputation of the British accounting firms.

The Committee had published its report and Code of Best Practice in December 1992. From July 1993, all companies registered in the UK and listed on the London Stock Exchange have been obliged to state in their Annual Report, how far they comply with the Code and to give reasons for areas of non-compliance. It recommends for a properly constituted Audit Committees of the board of directors reporting on the effectiveness of their systems of internal control and financial control. The basic governance issues relate to the effectiveness and accountability of boards of directors. Effectiveness is measured by performance.

The important highlights of the report are stated below:

The board

Boards of directors are responsible for the governance of their companies. Tests of board effectiveness include the way in which members act as a whole and their collective ability to provide both the leadership, and the checks and balances.

Financial reports

The boards should pay particular attention to their duty to present a balanced and understandable assessment of their company's position. The words are as important as figures. The cardinal principle of financial reporting is that the view presented should be true and fair. The points emphasized are:
a) The more the activities of the Companies are transparent, the more accurately their securities be valued.

b) The boards should pay particular attention to their duty to present a balanced and understandable assessment of their company's position and

c) The views presented should be true and fair. The board should ensure that the highest level of disclosure consonant with avoiding damage to their competitive position. The board should also aim to ensure the integrity and consistency of their reports.

Auditing

The annual audit is one of the cornerstones of corporate governance. Companies are made accountable for their actions through open disclosures and audits carried out against strict accounting standards.

Shareholders

While shareholders cannot be involved in the direction and management of their company, they can insist on high standard of corporate governance. Good governance is an essential test of the directors' stewardship. Companies coming to the international market shall treat all shareholders equally, to respect the rights of minorities, to abandon differential voting systems and to unwind the cross directorships and cross shareholdings common in some countries.
3.2 **GREENBURY COMMITTEE**

Greenbury Committee was appointed in United Kingdom to examine mostly the remuneration aspects of directors of a company, since Cadbury committee did not give enough attention to this aspect. Greenbury Committee emphasized the need for a remuneration committee for Board of directors. The following is the summary of the recommendation of the Greenbury committee.

**The Remuneration Committee**

1. To avoid potential conflicts of interest, boards of directors should set up remuneration committees of non-executive directors to determine on their behalf, and on behalf of the shareholders, within agreed terms of reference the company’s policy on executive remuneration and specific remuneration packages for each of the executive directors, including pension rights and any compensation payments.

2. Remuneration committee Chairman should account directly to the shareholders through the means specified in this Code for the decisions their committees reach.

3. Where necessary, companies’ Articles of Association should be amended to enable remuneration committees to discharge these functions on behalf of the Board.

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1 Greenbury Committee, *Recommendations on Corporate Governance*
4. Remuneration committees should consist exclusively of non-executive directors with no personal financial interest other than as shareholders in the matters to be decided, no potential conflicts of interest arising from cross-directorships and no day-to-day involvement in running the business.

5. The members of the remuneration committee should be listed each year in the committee's report to shareholders. When they stand for re-election, the proxy cards should indicate their membership of the committee.

6. The board itself should determine the remuneration of the non-executive directors, including members of the remuneration committee, within the limits set in the Articles of Association.

7. Remuneration committees should consult the Company Chairman and/or Chief Executive about their proposals and have access to professional advice inside and outside the company and

8. The remuneration committee Chairman should attend the company's Annual General Meeting (AGM) to answer shareholders' questions about directors' remuneration and should ensure that the company maintains contact as required with its principal shareholders about remuneration in the same way as for other matters.

Disclosure and approval provisions

1. The remuneration committee should make a report each year to the shareholders on behalf of the Board. The report should form part of, or be
annexed to, the company's Annual Report and Account. It should be the main vehicle through which the company accounts to shareholders for directors' remuneration and

2. The report should set out the Company's policy on executive remuneration, including levels, groups of companies, individual components, performance criteria and measurement, pension provision, contracts of service and compensation commitments on early termination

Remuneration policy

1. Remuneration committees must provide the packages needed to attract, retain and motivate directors of the quality required but should avoid paying more than is necessary for this purpose.

2. Remuneration committees should judge where to position their company in relation to other companies. They should be aware of what other comparable companies are paying and should take account of relative performance.

3. The performance-related elements of remuneration should be designed to align the interests of directors and shareholders and to give directors keen incentives to perform at the highest levels.
Service contracts and compensation

1. Remuneration committees should consider what compensation commitments their directors' contracts of service, if any would entail in the event of early termination, particularly for unsatisfactory performance.

2. If it is necessary to offer longer notice or contract periods, such as three years to new directors recruited from outside, such periods should reduce after the initial period.

3. Within the legal constraints, remuneration committees should tailor their approach in individual early termination cases to the wide variety of circumstances. The board's aim should be to avoid rewarding poor performance while dealing fairly with cases where departure is not due to poor performance.

4. Remuneration committees should take a robust line on payment of compensation where performance has been unsatisfactory and on reducing compensation to reflect departing directors' obligations to damages by earning money elsewhere.

5. Where appropriate, and in particular where notice or contract periods exceed one year, companies should consider paying all or part of compensation in instalments rather than one lump sum and reducing or stopping payment when the former director takes on new employment.
As can be seen above, the recommendations of the Greenbury Committee were aimed at the process of appointing and remunerating the directors based on performance.

3.3 ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

The Organization for Economic Co-operation and Development (Europe) recommended the following Codes for Corporate Governance.

1. The rights of shareholders should be safeguarded
2. All shareholders including minority and foreign shareholders should be treated equally. All shareholders of the same class should be treated equally.
3. Insider trading and abusive self-dealing should be prohibited;
4. Any material interests in transactions or board of directors and managers of the company should disclose matters affecting the corporation and
5. The following key functions are to be fulfilled by the board:
   a. Monitoring the effectiveness of the governance practices under which it operates and making changes as needed;
   b. Supervising the process of disclosure and communication and
   c. Reviewing key executive and board remuneration and ensuring a formal and transparent board nomination process.

The World Bank Report on Corporate Governance presented a historical view of developments in corporate governance. Corporate governance systems have evolved over countries often in response to corporate failures or systematic crisis. The first well-documented failure of governance was the South Sea Bubble in the 1700s, which revolutionized business laws and practices in England. Countries realize that just as overall governance is important in the public sector so corporate governance is important in the private sector. They also realize that good governance of corporations is a source of competitive advantage and critical to economic and social progress.

Sound corporate governance is important not only to attract long-term foreign capital, but more especially to broaden and deepen local capital markets by attracting local investors both individual and institutional. Unlike International investors who can diversify their risk, domestic investors are often captive to the system and face greater risks.

Corporate governance has only recently emerged as a discipline in its own right although the strands of political economy it embraces stretch back through centuries. The importance of the subject is widely recognized but the terminology and analytical tools are still emerging. From a public policy

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perspective corporate governance is about nurturing enterprise while ensuring accountability in the exercise of power and patronage by firms. The role of public policy is to provide firms with the incentives and discipline to minimize the divergence between private and social returns and to protect the interests of shareholders. The governance problems that need to be addressed vary according to the ownership structure in the corporate sector.

Among the most prominent systems of corporate governance in the developed countries are the U.S. & U.K. models which focused on dispersed controls and the German & Japanese models which reflect a more concentrated ownership structure. Recently many countries and firms have updated their systems of corporate governance to reflect more inclusive concept of corporate responsibilities that includes stake holders. Despite the diversity of corporate governance systems the globalization of markets is producing a degree of convergence in actual operations and governance practices. Countries and firms compete on the price and quality of their goods and services They compete for financial resources in global capital markets increasingly.

The rich and complex governance system (of policy laws, regulations, public institutions, self regulated professional bodies and managerial ethics) has evolved over centuries in developed market economies. In emerging markets however many elements of this are absent or countries are not well equipped to address the corporate governance challenges they face. These challenges are all the more daunting because of the complexity of the ownership structure of the
corporate sector, interlocking relationships with government and the financial sector where legal and judicial systems are absent.

The ownership pattern across developed, developing and transition economies is extremely varied. Among successfully developed economies both dispersed and concentrated shareholdings have provided an efficient base for growth and capital accumulation as long as there has been a well functioning legal and regulatory framework. The environment is different in many emerging market economies. The widely held publicly traded firms that constitute a significant part of the corporate sector in many developed countries are rare in emerging market economies. A more common pattern in developing countries is one of dominance by public sector companies or closely held family owned and managed conglomerates with complex shareholdings. This concentrated pattern of ownership allows insiders to have tight control of the firm.

3.5 REPORT OF THE CONFEDERATION OF INDIAN INDUSTRY

The task force of Confederation of Indian Industry (CII) headed by Mr. Rahul Bajaj has prepared a report titled "Desirable Corporate Governance – A Code", which is the first Indian initiative of its kind on the subject. The task force has also dealt with the role of directors both executive and non-executive and reduction in the number of directorship held. The task force has

5 Confederation of Indian Industry, Desirable Corporate Governance – A Code, New Delhi, April 1998.
recommended transparent corporate disclosure norms for all companies beyond a specified ceiling of the paid-up share capital and has emphasized that the quality and quantity of disclosure that accompanies the Global Depository Receipts issue should be the norms for any domestic issue.

DESIRABLE CORPORATE GOVERNANCE

The basic recommendations as given in “Desirable Corporate Governance – A Code” are reproduced below:

Recommendation 1

There is no need to adopt German system of two-tier boards to ensure desirable corporate governance. A single board, if it performs well, can maximize long term shareholder value just as well as a two-or multi-tiered board. Equally, there is nothing to suggest that a two-tier board, per se, is the panacea to all corporate problems.

Recommendation 2

Any listed company with a turnover of Rs. 100 crores and above should have professionally competent, independent, non-executive directors who should constitute
- at least 30 percent of the board if the Chairman of the company is a non-executive director, or
- at least 50 percent of the board if the Chairman and Managing Director is the same person.
Recommendation 3

No single person should hold directorships in more than 10 listed companies.

Recommendation 4

For non-executive directors to play a material role in corporate decision-making and maximizing long-term shareholder value, they need to

- become active participants in boards, not passive advisors;
- have clearly defined responsibilities within the board such as the Audit Committee; and
- know how to read a balance sheet, profit and loss account, cash flow statements and financial ratios and have some knowledge of various company laws. This, of course, excludes those who are invited to join boards as experts in other fields such as science and technology.

Recommendation 5

To secure better effort from non-executive directors, companies should:

- Pay a commission over and above the sitting fees for the use of professional inputs. The present commission of 1% of net profits (if the company has a managing director), or 3% (if there is no managing director) is sufficient.
- Consider offering stock options, so as to relate rewards to performance. Commissions are rewards on current profits. Stock options are rewards
contingent upon future appreciation of corporate value. An appropriate mix of the two can align a non-executive director towards keeping an eye on short-term profits as well as longer-term shareholder value.

**Recommendation 6**

While re-appointing members of the board, companies should give the attendance record of the concerned directors. If a director has not been present (absent with or without leave) for 50 percent or more meetings, then should be explicitly stated in the resolution that is put to vote. As a general practice, one should not re-appoint any director who has not had the time to attend even one half of the meetings.

**Recommendation 7**

Key information that must be reported to, and placed before the board and must contain:

- Annual opening plans and budgets, together with up-dated long term plans.
- Capital budgets, manpower and overhead budgets.
- Quarterly results for the company as a whole and its operating divisions or business segments.
- Internal audit reports, including cases of theft and dishonesty of a material nature.
Show cause, demand and prosecution notices received from revenue authorities, which are considered to be materially important. (Material nature if any exposure that exceeds 1 percent of the company's net worth).

Fatal or serious accidents, dangerous occurrences and any effluent or pollution problems.

Default in payment of interest or non-payment of the principal on any public deposit and/or to any secured creditor or financial institution.

Defaults such as non-payment of inter-corporate deposits by or to the company, or materially substantial non-payment for goods sold by the company.

Any issue, which involves public or product claims of a substantial nature, including any judgement or order which may have either passed strictures on the conduct of the company, or taken an adverse view regarding another enterprise that can have negative implications for the company.

Details of any joint venture or collaboration agreement.

Transactions that involve substantial payment towards goodwill, brand equity, or intellectual property.

Recruitment and remuneration of senior officers just below the board level, including appointment or removal of the Chief Financial officer and the Company Secretary.

Labour problems and their proposed solutions.

Quarterly details of foreign exchange exposure and the steps taken by management to limit the risks of adverse exchange rate movement, if material.
Recommendation 8

1. Listed companies with either a turnover of over Rs. 100 crores or a paid-up capital of Rs.20 crores should set up Audit Committees within two years.

2. Audit Committees should consist of at least three members, all drawn from a company's non-executive directors, who should have adequate knowledge of finance, accounts and basic elements of company law.

3. To be effective, the Audit Committees should have clearly defined Terms of References and it's members must be willing to spend more time on the company's work vis-à-vis other non-executive directors.

4. Audit Committees should assist the board in fulfilling its functions relating to corporate accounting and reporting practices, financial and accounting controls, and financial statements and proposals that accompany the public issue of any security -and thus provide effective supervision of the financial reporting process.

5. Audit Committees should periodically interact with the statutory auditors and the internal auditors to ascertain the quality and veracity of the company's accounts as well as the capability of the auditors themselves.

6. For Audit Committees to discharge their fiduciary responsibilities with due diligence, it must be incumbent upon management to ensure that members of the committee have full access to financial data of the company, its subsidiary and associated companies, including data on contingent liabilities, debt exposure, current liabilities, loans and investments.

7. By the fiscal year 1998-99, listed companies satisfying criterion (1) should have in place a strong internal audit department, or an external auditor to do internal audits; without this, any Audit Committee will be toothless.
Recommendation 9

Under "Additional Shareholder's information", listed companies should give data on:

1. High and low monthly averages of share prices in a major Stock Exchange where the company is listed for the reporting year.
2. Greater detail of business segments, up to 10% of turnover, giving share in sales revenue, review of operations, analysis of markets and future prospects.

Recommendation 10

1. Consolidation of Group Accounts should be optional and subject to:
   - the FIs allowing companies to leverage on the basis of the group's assets, and
   - the Income Tax Department using the group concept in assessing corporate income tax.
2. If a company chooses to voluntarily consolidate, it should not be necessary to annex the accounts of its subsidiary companies under section 212 of the Companies Act.
3. However, if a company consolidates, then the definition of "group" should include the parent company and its subsidiaries (where the reporting company owns over 50% of voting stake).
Recommendation 11

Major Indian stock exchanges should gradually insist upon a compliance certificate, signed by the CEO and CFO, which clearly states that:

- The management is responsible for the preparation, integrity and fair presentation of the financial statements and other information in the Annual Report, which suggest that the company will continue in business in the course of the following year.

- The accounting policies and principles conform to standard practice, and where they do not, full disclosure has been made of any material departures.

- The board has overseen the company's system of internal accounting and administrative controls systems either directly or through its Audit Committee (for companies with a turnover of Rs.100 crores or paid-up capital of Rs.20 crores).

Recommendation 12

For all companies with paid-up capital of Rs.20 crores or more, the quality and quantity of disclosure that accompanies a GDR issue should be the norm for any domestic issue.
Recommendation 13

Government must allow far greater funding to the corporate sector against the security of shares and other paper.

Recommendation 14

It would be desirable for FIs as pure creditors to re-write their covenants to eliminate having nominee directors except:

a) in the event of serious and systematic debt default; and

b) in case of the debtor company not providing six-monthly or quarterly operational data to the concerned FI(s).

Recommendation 15

1. If any company goes to more than one credit rating agency, then it must divulge in the prospectus and issue documents the rating of all the agencies that did such an exercise.

2. It is not enough to state the ratings. These must be given in a tabular format that shows where the company stands relative to higher and lower ranking. It makes considerable difference to an investor to know whether the rating agency or agencies placed the company in the top slots, or in the middle, or in the bottom.

3. It is essential that we look at the quantity and quality of disclosures that accompany the issue of company bonds, debentures, and fixed deposits in
the USA and Britain—if only to learn what more can be done to inspire confidence and create an environment of transparency.

4. Finally, companies, which are making foreign debt issues, cannot have two sets of disclosure norms: an exhaustive one for the foreigners, and a relatively minuscule one for Indian investors.

**Recommendation 16**

Companies that default on fixed deposits should not be permitted to

- accept further deposits and make inter-corporate loans or investments until the default is made good; and
- Declare dividends until the default is made good.

**Recommendation 17**

- Reduction in the number of companies where there are nominee directors.

It has been argued by FIs that there are too many companies where they are on the board, and too few competent officers to do the task properly. So, in the first instance, FIs should take a policy decision to withdraw from boards of companies where their individual shareholding is 5 percent or less, or total FI holding is under 10 percent.
3.6 ASSOCIATED CHAMBERS OF COMMERCE AND INDUSTRY

The Associated Chamber of Commerce and Industry recommended the following principles of corporate governance.

1. The very increase in the size of a company, the enlargement of its membership, the dispersal of the members, the expansion in the scale of its operations resulted in the divorce of ownership from management. The widening gulf between ownership and management of corporate undertakings necessitates a clear concept of corporate governance.

2. Laws never prescribe what is good and right; they content themselves with prescribing what is bad and wrong. Corporate governance needs, therefore, a wider perspective than legal requirements.

3. Corporate governance is the setting up objectives for the managers, who will be charged with the responsibility for converting the objectives into goals and achieving the targets. Its task is to lay down the policy, identify the areas of a company’s core competence, decide the extent to which diversification may be essential or/and feasible, formulate a strategy for attaining its objectives and arrange for the discharge of the company’s obligation to all its stake-holders.

4. Single method of corporate governance is not possible for companies engaged in trading or manufacturing, or providing financial or other

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6 The Associated Chambers of Commerce and Industry of India. Corporate Governance.
services. Strategies of governance cannot be uniform or rigid or fixed for all types of activities, everywhere, or for all the time.

5. In large companies, financial institutions have large stakes. So, they should appoint experts as nominees in the concerned field. Nominees will not only safeguard interest of the financial institutions, but also in the process, examine the measures for increasing a company’s productivity and profitability and avoiding financial and other irregularities.

6. When the Board of directors find themselves unable to accept the advice of the Audit committee on any issue, the board should be competent to overrule the advice but should be required to report the facts fully to the general body of shareholders at the next annual general meeting for their information.

7. The promoters who take no active part in the board and treat the directorship for no work but for payment has to be dispelled.

8. Companies should avoid to combine the posts of Chairman and Managing Director in the same individual.

9. In the Articles of the company or in the appointment letter of the directors, the duties and responsibilities of the directors should be mentioned and

10. A company should concentrate not only on wealth maximization of the shareholders but also on the social responsibilities and the accountability to its stakeholders.
The committee under the chairmanship of Kumaramangalam Birla was set up on May 7th, 1997, by the Securities and Exchange Board of India to promote and raise the standards of corporate governance. The committee's mandatory recommendations are:

**Independent directors and the definition of independence**

Among the non-executive directors are independent directors, who have a key role in the entire mosaic of corporate governance. Independent directors are directors who apart from receiving director's remuneration do not have any material pecuniary relationship or its subsidiaries, which in the judgement of the board may affect their independence of judgement. Further, all pecuniary relationships or transactions of the non-executive directors should be disclosed in the annual report.

The law does not make any distinction between the different categories of directors and all directors are equally and collectively responsible in law for the board’s actions and decisions. The Committee is of the view that the non-executive directors bring an independent judgement to bear on board’s deliberations especially on issues of strategy, performance, management of conflicts and standards of conduct. The Committee therefore lays emphasis on

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the caliber of the non-executive directors, especially of the independent directors.

The Committee recommends that the board of a company have an optimum combination of executive and non-executive directors with fifty percent of the board comprising of the non-executive directors. The number of independent directors would depend on the nature of the chairmanship of the board. 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 be independent.

Nominee Directors

The Committee recommends that the financial institutions should have no direct role in managing the company, and should normally not have nominees on the board, merely by virtue of their financial exposure by way of investment in the securities of a company. There is however a case for the term lending institutions to have nominees on the Board of the borrower companies to protect their interests as creditors. In case of loan default or potential loan default the nominee directors should take an active interest in the activities of the board and have to assume equal responsibility, as any other director in the board.
Chairman of the Board

Given the importance of Chairman's role, the Committee recommends that a non-executive Chairman should be entitled to maintain a Chairman's office at the company's expense and also be allowed reimbursement of expenses incurred in performance of his duties. This will enable him to discharge the responsibilities effectively.

Audit Committee

The committee recommends that a qualified and independent audit committee should be set up by the board of a company. This would go a long way in enhancing the credibility of the financial disclosure of a company and promoting transparency.

Composition of the audit committee

The composition of the audit committee is based on the fundamental premise of independence and expertise. The committee, therefore, recommends that

- The audit committee should have a minimum of three non executive directors, majority being independent, with at least one director having financial and accounting knowledge;
- The chairman of the committee should be an independent director;
- The chairman should be present at Annual General Meeting to answer shareholder queries;
- The finance director, head of internal audit and a representative of external auditor should be present as invitees for the meetings of the audit committee; and
- The company secretary should act as the secretary of the committee

**Frequency of meetings and quorum**

The Committee recommends that to begin with the audit committee should meet at least thrice a year. One meeting must be held before finalization of annual accounts and one necessarily every six months. The quorum should be either two members or one-third of the members of the audit committee, whichever is higher.

**Powers of the audit committee**

Being a committee of the board, the audit committee derives its powers from the authorization of the board. The committee recommends that such powers should include:

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

For this purpose the committee recommends that the board should set up a remuneration committee to determine on their behalf and on behalf of the shareholders with agreed terms of reference, the company's policy on specific remuneration packages for executive directors including pension rights and any compensation payment.

Board Procedures

The Committee recommends that board meetings should be held at least four times in a year, with a maximum time gap of four months between any two meetings. The committee further recommends that to ensure that the members of the board give due importance and commitment to the meetings of the board and its committees, there should be a ceiling on the maximum number of committees across all companies in which a director could be a member or act as chairman. The Committee recommends that a director should 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.

Management

The Committee recommends that the board should clearly define the role of the management. The Committee recommends that the management should carry out the following functions:
- Assisting the board in its decision making process in respect of the company’s strategy, policies, code of conduct and performance targets, by providing necessary inputs;

- Implementing the policies and code of conduct of the board;

- Managing the day to day affairs of the company to best achieve the targets and goals set by the board, to maximize the shareholder value;

- Providing timely, accurate, substantive and material information, including financial matters and exceptions, to the board of directors, board-committees and the shareholders;

- Ensuring compliance of all regulations and laws;

- Ensuring timely and efficient service to the shareholders and to protect shareholder’s rights and interests;

- Setting up and implementing an effective internal control systems, commensurate with the business requirements;

- Implementing and complying with the Code of Ethics as laid down by the board; and

- Co-operating and facilitating efficient working of board committees.

As a part of the disclosure related to management, the committee recommends that in addition to the director’s report; management Discussion and Analysis report should form part of the annual report to the shareholders. This Management Discussion & Analysis should include the following 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; and
- Material developments in Human Resources /Industrial Relations front, including number of people employed.

Good corporate governance casts an obligation on the management in respect of disclosures. The Committee therefore recommends that 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.

Responsibilities of shareholders

The Committee recommends that in case of the appointment of a new director or re-appointment of a director a shareholder must be provided with the following information:
- A brief resume of the director;
- Expertise in specific functional areas; and
- Names of companies in which also the person holds the directorship and the membership of Committees of the board.

**Shareholder’s right**

The Committee recommends that information like quarterly results and presentation made by companies to analysts may be put on company’s web site or may 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. The Committee recommends that the half-yearly declaration of financial performance including summary of the significant events, in the last six-months, should be sent to each shareholder.

The Committee recommends that a board committee under the chairmanship of a non-executive director should be formed to specifically look into the redressal of shareholder complaints like transfer of shares, non-receipt of balance sheet, non-receipt of declared dividends etc. The Committee believes that the formation of such a committee will help focus the attention of the company on shareholders’ grievances and sensitize the management to the redressal of their grievances. The Committee further recommends that to expedite the process of share transfer the board of the company should delegate the power of share transfer to the registrars and share transfer agents.
Institutional shareholders

The committee recommends that the institutional shareholders:

- Take active interest in the composition of the board of directors;
- Be vigilant;
- Maintain regular and systematic contact at senior level for exchange of views on management, strategy, performance and the quality of management;
- Ensure that voting intentions are translated into practice; and
- Evaluate the corporate governance performance of the company

Manner of Implementation

The Committee recommends to SEBI, that as in other countries, the mandatory provisions of the recommendations may be implemented through the listing agreement of the stock exchanges. The Committee recognizes that the listing agreement is not a very powerful instrument and the penalties for violation are not sufficiently stringent to act as a deterrent. The Committee therefore recommends to SEBI, that the listing agreement of the stock exchanges is strengthened and the exchanges themselves are vested with more powers, so that they can ensure proper compliance of Code of Corporate Governance. In this context, the committee further recommends that the Securities Contract (Regulations) Act, 1956 should be amended, so that in addition to the above, the concept of listing agreement be replaced by listing conditions. The Committee also recommends that SEBI writes to the
Department of Company Affaires for suitable amendments to the Companies Act in respect of the recommendations, which fall within their jurisdiction.

The Committee recommends that there should be a separate section on Corporate Governance in the annual reports of companies, with a detailed compliance report of Code of Corporate Governance. Non-compliance of any section of the code and the reasons thereof should be specifically highlighted. This will enable the shareholders and the securities market to assess for themselves the standards of corporate governance followed by a company.

Schedule of implementation

The Committee recommends that the mandatory recommendations of the Committee, such as composition of the Board, constitution of the various subcommittees of the board of directors, should be implemented by companies within the time prescribed below:

- Immediately by all companies seeking listing for the first time.
- By April 2000 by those companies, which satisfy any of the following criteria: Paid up share capital is Rs. 10 crore and above; or net worth has reached Rs. 25 crores any time in the history of the company.
- By April 2001 by those companies, which qualify the following criteria: Paid up share capital of Rs. 5 crore and above.
Postal Ballot system

Voting at the general meetings of companies is the most valuable and fundamental mechanism by which the shareholders accept or reject the proposals of the board of directors as regards the structure, the strategy, the ownership and the management of the corporation. Voting is the only mechanism available with the shareholders for exercising an external check on the board and the management.

Under the present framework of the Companies Act, 1956, a company is required to obtain the approval of its shareholders for various important decisions such as increase in its authorized capital, shifting of registered office, change in the name, amalgamation and reconstitution, buy-back of shares, further issue of shares, etc. Since the shareholders of any large public listed company are scattered throughout the country, they are unable to physically attend the general meetings of the company to exercise their right to vote on matters of vital importance. The system of voting by proxy has also not proved very effective. With a view to strengthening shareholder democracy, it is felt that all the shareholders of a company should be given the right to vote on certain critical matters through a postal ballot system, which has also been envisaged in the Companies Bill, 1997.
Since the emergence of corporate governance in India the Institute of Company Secretaries of India has provoked an interest in its members by organizing various programs, seminars and also by publishing a special issue of "Chartered Secretary". It has published a questionnaire to formulate the principles on corporate governance in its journal 'Chartered Secretary' July 1999 issue.

It consists of three parts such as

1. **Corporate Governance** – conceptual clarity and focus;
2. (a) Role of various agencies in promoting corporate governance;
   (b) Need for evolving a voluntary code of best corporate practices; and
3. Global perceptions and developments in the area of corporate governance.

It is believed that the institute would come up with practical guidelines for implementing a code of good corporate governance.

**Quarterly Disclosures from Companies**

The Securities and Exchange Board of India [SEBI] plans to ask for quarterly disclosure of financial results from public limited companies. As per the current guidelines, a company has to send to its shareholders, audited balance

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sheets and report annually and publish an audited financial results on a half-yearly basis. Whenever the Indian companies issued Global Depository Receipts [GDR] they followed tough disclosure norms and declared quarterly financial figures.

The Malegam committee had set up new standards of disclosures by the corporates, which would be amended further in tune with the international standards. The responsibility of the audit committees in the area of corporate governance is to provide assurance that a corporation is in reasonable compliance with pertinent laws and regulations; is conducting its affairs and is maintaining effective controls against employee conflict of interest and fraud.

3.9 AUDIT COMMITTEES

Since all the committees recommended audit committees of board of directors a detailed discussion is presented in this section. Audit committees have now become committee of shareholders’ auditors. It could be termed as a positive development in internal management to prevent, detect and limit the fraudulent financial practices within the boundaries of corporate veil. Though the statutory auditor is known as a shareholder’s auditor, still in the realm of practical corporate experience, the true demand of shareholders to have audit committees to protect their interests has yet to be achieved in India.

The report of the working group on Companies Act, 1956[1997] also dealt with the demand for framing a model code of corporate governance and has concluded that there is a need to define the scope of the directors responsibilities.
This is sought to be achieved by recommending that there should be a specific statement of the responsibilities of the directors of a company. The group has recommended a model of the Directors Responsibility Statement [DRS], which could be published in its annual reports.

The size of business operations has complicated the question of disclosure as well as the question of materiality in disclosure of financial data and information presented through financial report. The new approach to corporate governance has taken the shape of audit committees in USA and Canada in particular, and of late, in developing countries as well. It is well known that fraudulent financial reporting as well as poor corporate performance has laid the foundation for audit committees.

The audit committees, in order to meet their objectives, should have a charter - a detailed description of their functional areas. This is to avoid any conflict or confrontation in the functional relationship with management, statutory auditors and internal auditors; the charter provides the means to spell out the authority conferred by the full board for the purpose, in addition to specifying in writing the audit committee's objectives, authority and responsibilities.

Responsibilities of Audit Committee

Audit committees have the responsibilities in the three important areas. Viz. 1. Financial reporting 2. Corporate governance and 3. Corporate control.
In the area of financial reporting the responsibility of audit committee is to provide assurance that financial disclosures made by management responsibly portray the company's financial position, results of operations and the company's plans and long-term commitments. The responsibility of audit committees in the areas of corporate governance is to provide assurance that the corporation is in reasonable compliance with pertinent laws and regulations; in conducting its affairs ethically; and is maintaining effective controls against employee conflict of interest and fraud. In the area of corporate control the committee's responsibility includes an understanding of the company's financial reporting, areas and the system of internal control.

**Meaning of Audit Committee**

In the United States, the audit committee, in listed companies, is a main board committee consisting wholly of outside [non-executive] directors with an outside chairman, responsible to the board, to provide non-executive directors with direct and more personal contact with the independent auditors, to strengthen the audit function, and to undertake whatever other duties the board may delegate. For instance, the New York stock exchange, American stock exchange and NASDAQ all require their member companies to have an audit committee with majority of independent or non-executive directors. In the UK, both the Cadbury and King reports have recommended establishment of audit committees. While the Cadbury report suggests at least three non-executive directors, the King report feels that the majority of the members of the audit committee [including its chairman] should be non-executive directors. Both reports recommend written terms of reference. In
Pakistan, very few companies have audit committees and where they are present they have limited powers. In fact, audit committees are seldom consulted.

The functions of audit committee can vary. It includes standard auditing reviews, reviewing compliance policies, ethical policies, and practice reviews. It deals with accounting matters, financial reporting and internal controls. It reviews the annual and semi-annual [interim] financial statements before they are submitted to the board. It monitors proposed changes in accounting policy, reviews the internal audit functions, meets external auditors, and discusses the accounting implications of major transactions. At times, it is also given the task of assessing the effectiveness of information technology system and reviewing legal matters, environmental affairs, pension investment performance, and other areas.

**Functions of Corporate Audit Committee**

The functions of corporate audit committee are as follows;

i. To discuss with independent auditors any problem and experience in completing the audit;

ii. To discuss the scope and timing of independent audit work;

iii. To discuss the effectiveness of internal controls;

iv. To discuss meaning and significance of audited figures and notes thereto;

v. To approve or nominate independent auditors. The audit committees might also undertake to

i. Discuss adequacy of staffing for internal audit;

ii. Discuss findings and recommendations of internal audit;
iii. Discuss adequacy of staffing for accounting and financial responsibilities;

iv. Discuss organization and independence of internal auditors;

v. Discuss plans of internal audit function;

vi. Review accounting principles and practices followed by the company;

vii. Discuss effectiveness of procedures to prevent conflicts of interest political contributions; and

viii. Discuss effectiveness of use and control of data processing.

In some cases the audit committee reviews financial data before release to the press, or distribution or shareholders, and reviews reports before submission to regulatory bodies. Wider roles for the audit committee are being suggested by some. One such idea is to provide an independent assessment of management performance. The significant feature here is the concept of 'special interest groups' which is taken to mean directors appointed to boards as representatives of consumer groups and minority interests.

Successful Practice of Audit Committees

The rapid development in North America provides some indication of their usefulness. But that has to be interpreted in the light of the situation facing directors there. In evidence, too, during this study a number of businessmen, experienced in the operations of North American audit committees, counselled
caution in reporting enthusiastically on the evidence of their growth and acceptability.

**Implications of Audit Committees**

The rationale for the audit committee, as we have seen, is two fold -- to provide authority for the non-executive directors and to preserve independence for the auditor. Disputes and difficulties in financial reporting and criticism of management can be resolved or reported to the shareholders where necessary. Other positive benefits can accrue, for example:

I. The efficiency/effectiveness of the whole board may be improved by delegating relevant tasks;

II. The special talents of the non-executives can be better utilized;

III. The audit committee members will learn more about the business;

IV. Communication between auditor and client company may be improved;

V. Management may be stimulated by independent assessments in addition to that of the auditors; and

VI. The auditor's independence can be, and be seen to be, maintained.

On the legal side a properly constituted audit committee would have the implications of any other main board committee. A director needs to exhibit in the performance of his duties only that degree of skill that may be reasonably expected from a person of his knowledge and experience. In the absence of any grounds for suspicion other directors may rely on the members of the audit committee performing their duties honestly.
Present State of Corporate Governance vis-à-vis Audit Committees

Although audit committees were prescribed by financial institutions almost 15 years ago, the efficacy of audit committees in India has been doubtful for various reasons. The matters which come up to the audit committees have been mainly accountancy oriented and not systems and value oriented. Absence of systems and value audit has reduced effectiveness of audit committees. Although audit committees have been in existence as a corporate structure for quite sometime, however with the emergence of Business Process Re-engineering (BPR) and Enterprise Resource Planning (ERP), more and more companies are forced to look at the systems and processes for better governance. If not by better legislation, the force of competition would make companies in India set up and have a fresh look at audit committees and the process of audit committees are involved in. In a time frame of 3-5 years, it is the conviction of this researcher that audit committees would not be of really looking at accountancy oriented issues but would assist in the task of better corporate governance through a good review of BPR systems and an objective audit of various facets of corporate functions. As the Cadbury Committee concluded, in India too audit committees would hopefully usher in much needed support for the cause of corporate governance.
3.10 INDIAN CORPORATE BOARDS

Corporate governance at the highest level is the board of directors. Irrespective of more and more international exposure, by and large the Indian boardroom continues to function in the same old traditional fashion. Apart from a few professionally managed companies not many changes have come in this topmost position in for corporate management structure.

In a typically good sized Indian corporate, the total shareholding is controlled or shared more or less equally among the promoters, the financial institutions and the public, i.e., individual small share holders. With their stakes varying between anything from 25 percent to 35 percent, the promoters and their nominees rule the company. Despite nearly equal or sometimes even more holding the institutions and their nominees are generally silent spectators and supporters of the management. The small shareholders have no representation or say in the corporate governance.

Barring a few, in large number of companies hardly any relevant business information is passed on to the directors and the meetings of the Board generally discuss only trivial and routine matters. Even where the Board is briefed about the major developments or strategic changes, there is hardly sufficient time or data made available in advance for the outside directors to meaningfully participate. The Board meetings are generally between 1 to 3 hour's duration, in an interval of 2 to 3 months. It is well high impossible to have any in-depth deliberation or participation in the overall business of the company within such a short duration of
time. As a result, in most of the cases, the Directors by and large endorse the management views on the matter.

In professionally managed companies the CEO is a well-respected and impartial leader and enjoying the total trust and faith of all shareholders. There are bickering and rivalries amongst the professional directors and in the process the board also gets divided losing the homogeneity, very vital for its successful functioning.

Board’s and Management’s Accountability to Investor

One very important concern is the accountability of the corporation, its board and management towards its investors. Very few corporates have shown a responsible behaviour in this area. Even in the recent past number of promoters have usurped sizable benefits at the cost of the small individual shareholders by grabbing large chunk of shares at cheap prices through preferential allotments. Rigging of share prices, insider trading and managing personal gains are common practices resorted to by managements of the companies ultimately at the cost of investing public. Despite recognizing these malpractices hardly anything effective has been done to control and eradicate them. Honesty, only a few promoters and corporates are concerned about their accountability to the investors.

- To sum up, Corporate governance has been defined in the Cadbury Report as a system by which companies are directed and controlled. Board of directors are responsible for the governance of their company. The shareholder’s role in governance is to appoint the directors, the auditors and to satisfy themselves that
an appropriate governance structure is in place. The responsibilities of the board include setting the company’s strategic aims, providing leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship. The board actions are subject to laws, regulations and shareholders in general meeting.

Kumaramangalam Birla committee recommends that board meetings should be held at least four times in a year, with a maximum time gap of four months between any two meetings. The committee further recommends that the members of the board give due importance and commitment to the meetings of the board and its committees. The committee insists that there should be a ceiling on the maximum number of committees across all companies in which a director could be a member or act as chairman.

Kumaramangalam Birla committee also recommends that a director should not be a member in more than ten committees or act as chairman of more than five committees across all companies in which he is a director. Confederation of Indian Industry and Kumaramangalam Birla committee insist that the disclosures in the financial statements should be accurate and disclosure should be regular. They further insist that financial statements should reveal timely, accurate, substantive and material information. Organisation for Economic Co-operation and Development (Europe) recommend that any material interest in transactions or matters affecting the corporation should be disclosed by board of directors of the company.
All committees invariably recommend setting up of audit committees. Confederation of Indian Industry insist that listed companies with either a turnover of over Rs.100 crores or a paid up capital of Rs.20 crores should set up audit committees within two years. Both Kumaramangalam Birla committee and Confederation of Indian Industry recommend that the audit committee should have maximum non-executive members, who should have adequate knowledge of finance, accounts and basic elements of company law. Cadbury committee recommends that the audit committee should have minimum of three members. Membership should be confined to the non-executive directors of the company and a majority of the non-executive directors serving on the committee should be independent. Membership of the committee should be disclosed in the annual report.

The Associated Chambers of Commerce and Industry recommend that the board of directors, when they find themselves unable to accept the advice of audit committees on any issue, should be competent to overrule the advice but should be required to report the facts fully to the general body of shareholders at the next annual general meeting for their information.

Confederation of Indian Industry and Kumaramangalam Birla committee recommend that non-executive directors should be included in the board of directors to bring an independent judgement to bear on issues of strategy, resources including key appointments and standards of conduct. Confederation of Indian Industry recommends, to secure better effort from non-executive directors, that companies should pay a commission over and above the sitting fees and consider offering stock options for the use of professional inputs. It further
recommends that independent directors should have clearly defined responsibilities with in the board and become active participants in boards, not passive advisors.

Greenbury committee was specially set up to report on remuneration policy. It recommends that the remuneration committee should be set up by the board of directors. The remuneration committee should consist of only non-executive directors. It further recommends that remuneration committees must provide the packages needed to attract, retain and motivate directors of the quality required but should avoid paying more than is necessary for this purpose.

Kumaramangalam Birla committee recommends that the remuneration committee should comprise minimum of three non-executive directors, the chairman of the committee being an independent director. The committee also recommends that the chairman of remuneration committee should be present at annual general meeting to answer the shareholder queries.

All committees invariably emphasize the need for increasing the value of shareholders by good corporate governance. The Associated Chamber of Commerce and Industry recommend the companies to concentrate not only on wealth maximisation of the shareholders but also on the social responsibility and the accountability to its other stakeholders.