Chapter 1
Corporate Governance
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Corporate Governance

1.1 Overview of Corporate Governance:

There has been an increase in interest in the Corporate Governance practices in modern era since 2001, particularly due to a number of high profile financial scandals of large corporations, most of which involved in accounting fraud such as Satyam Computers, Enron Corporation etc. After the number of corporate financial scandals in the early part of the decade, it raised the pressure on investors on companies to strengthen corporate governance system by separating the roles of chairman and CEO. In most US firms, traditional organisation normally CEO act as a chairman of the board (Keller et. al, 2006). They have also found that the governance structure at most 100 fortune companies has been complimented by a presiding or lead directors, who plays a substantial role in leading the board. The worldwide wave of deregulation, privatization, take over, pension fund reforms and the growth of private savings are the reasons why the corporate governance become so prominent today. Investors from developed countries are demanding that Indian companies to follow international best practices with an emphasis on corporate governance. A McKinsey survey conducted in 2002, found that investors were willing to pay a premium for a well governed company (Barton et al. 2006). Among all other forces, four major driving forces can be identified for the emergence of corporate governance in India. These include Globalization, Privatization, Unethical business practices and security scams.

The corporate governance concerned with many stakeholders and goals for which the corporation is formed. The effective and ethical governance practice of the corporate is to help the nation to grow economically. Government of any countries expects the growth, employment, wealth and satisfaction through effective governance. Additionally, it should raise the living standard of the society and increase in cohesiveness of society. The principle stakeholder of the corporation are shareholders, management and the board of directors. Other stakeholders include customers, creditors, suppliers, employees, regulators and the community at large. The prime concerned of corporate governance is to ensure the accountability of corporate and the mechanism that try to eliminate or reduce the agency
problem. It also deals with the mitigation and prevention of conflict for the best interest of stakeholders.

1.2 Evolution:
Since post era of liberalization, privatization and globalization, whole world faces problems related to governance practices in companies. Post-independence Indian governance practices were derived from the English legal system but there were poor implementation of those practices. Current governance practices are the result of many thinking and discussions of international practices and results. Large scale trading networks of merchants belonging to particular ethnic and sectarian groups go back centuries, and modern Indian business groups often correspond to these same groupings. When Indian began industrializing under the British Raj, these groups had the capita both to compete and to cooperate with Indian subsidiaries of the great British business groups of the era. It is found that group firms are typically older and larger than independent firms is consistent with both. The ranking of smaller Indian business groups are quite volatile, with groups appearing, rising, falling and disappearing. Turnaround around independence doubtless reflects the withdrawal from Indian and British business groups.

Such volatile speaks of a more entrepreneurial economy than is generally credited to post independence Indian, thus, business groups as an Organisational form persisted, but many individual business groups, especially smaller ones, did not.

Turnover among smaller business groups during all of this might indicate an entrepreneurial economy, in which innovative new businesses arise and old ones die out. The license Raj was clearly constructed to tie down and the great business groups, but its actual effect may have been the opposite. Only the largest groups could absorb the huge fixed cost of retaining the bureaucratic expertise needed to navigate the maze.

1.2.1 Ancient Era:
The roots of corporate governance practices in India found since ancient era. The concept of Trusteeship were practiced in Ramrajya. After the departure of Rama from Ayodhya, Bharat had taken the charge for management of Ayodhya. The role of Bharat was
Trusteeship i.e. he was managing the kingdom as a representative of his kingdom. This is the best example of separations of owners and management. It was also a successful governance practice in Indian history. Though, Bharat had managed Ayodhya for fourteen years, he was completely detached from the wealth and power. Same kind of governance practiced were observed in Mahabharta. Kingdom of Krishna was presidential state. Krishna and Balrama were the presidents of kingdom and not a kings. In both the cases absolute ethics was at the base of governance and these absolute ethical values were derived from the Vedas. The Indian principles gives the concept of the VARNASHRAM (Four class of the people based on Qualities and Efficiency). Due to division of work there were less chance for accumulation of wealth and power in hand of the few people. The principles also stress that there should be single source of income for an individual. Further the Indian ethos divides the individual’s activity in four parts i.e. (PURUSHARTH-Dharma, Artha, Kama, and Moksh). This reflects the proper work life balance for an individual.

1.2.2 Pre-Independence Governance Practices in India:
In India, until the beginning of seventeenth century most of the organizations were run jointly or family owned. During that period, the partnership was the dominant form for organization. The partners were bare unlimited personal liabilities for any obligations of the firm. At that time corporations were very small and formed for specific purposes to get few trade privileges. The first organization was came to exist at time of British was the British East India Company.

Increase in industrialization and globalization leads to requirement of the huge capital for large firms. Between 1895 and 1904, the first great merger wave in the US consolidated companies into mega corporations. In other words, the corporation was transformed from state-controlled organizations to unlimited private organizations with limited responsibility and limited accountability. During this time control of corporations shifted from owners to managers and thus leads to agency problem.

Across the world there are several models of corporate governance is in practice such as Anglo Saxon, Franco German, Japanese and the Family owned company model (Especially in India). The Indian corporate governance is nothing but the reflections of all these models which balances the interest of the stockholder at the same time considering the
responsibilities and duties towards key stakeholders. Though the Japanese model based on a network of suppliers and buyers of companies (Keiretsu) is not well practiced in India. In Asia. Particularly in India, small number of powerful families are controlling the majority of companies i.e. Reliance etc.

1.2.3 Post-Independence (Pre Liberalization) Governance Practices in India:\(^5\):b:
Post-independence governance practices were drawn from the Gandhian principles of Trusteeship and the some of the direction received from the Indian principles of constitutions. Ethics and values of duties were the base of these principles. Many corporates like JRD TATA has also imbibed these principles and established such a big empire of TATA group. While earlier governance management in India were more focused on the management of the agency system. In 1956 Companies act came to picture and main focus of the act was to govern the functioning of the joint stock companies and protecting the rights of the investor. But the contemporary laws were enough power to control unethical practices leads to inefficiency, nepotism and corruptions. There were increase in earning management practices and gave firms to incentives to develop complicated structures with large “Under the Table” compensation at senior level.

The financial manipulations, corporate bankruptcy and reorganization system has also create the worse picture of Indian corporate. India’s system was driven by Sick Industrial Companies Act 1985 which considers a company “sick” only after its entire net worth has been eroded and it has been referred to the Board for Industrial and Financial Reconstruction (BIFR). Only few companies are emerge successfully from the BIFR in between 1987 and 1992. Additional the average 10 year has been taken by the legal process to liquidate by that time the company’s assets were almost become worthless. So the protections of the creditor’s right remained only on a paper.

1.2.4 Post Liberalization Governance Practices in India:\(^5\):
In India liberalization began in 1991 and leads to wide ranging changes in both law and regulations. After the liberalization the establishment of the Securities and Exchange Board of India (1992) was very important development in the field of corporate governance and protection of the minority investors’ rights. The important function of the SEBI is to
monitor the stock trading. After 1992 due to Harshad Mehta scam, companies allotting preferential share to their promoters at discounted prices and those companies disappearing with investor’s money leads to several investigations to fix the corporate governance practices in India.

The first such endeavor was made by the CII (Confederation of Indian Industry Code) for evolution of existing governance practices and suggestions for improvement and modification regarding the same. The committee was formed in 1996 and chaired by Rahul Bajaj. They had submitted its code in 1998. During this period SEBI had also constituted two committees to look after the issues related to corporate governance, the first committee was chaired by Kumar Manglam Birla and submitted its report in early 2000; second by Narayan Murthy and submitted its report three years later. The discussions and suggestions of these two committees become important means for bringing effective changes in corporate governance in India through the formulation of clause 49.

Concurrent with the initiatives taken by SEBI, the DCA (Department of Company Affairs), the Ministry of Finance of the Government of India had also began to rethink on existing practices and implement required modifications for same. Various committees were formed to reform the existing Companies Act of 1956 that still forms the backbone of corporate law in India. The Committees were chaired by Kumar Manglam Birla in 2000, Naresh Chandra on corporate Audit and Governance in 2002, and J. J. Irani on corporate law in late 2004.

The SEBI implemented the recommendations of the Birla committee through the enactment of Clause 49. The clause was applicable to all companies which were listed on stock exchange like BSE 200 and S&P C&X Nifty Indices etc. These regulations are applicable to all the companies with Paid up capital of Rs. 10 Crore or net worth of Rs. 25 Crore at any time in the previous five year on March 31, 2002. It also applicable to other listed companies with the paid up capital over Rs. 3 Crore on March 31, 2003. Further clause 49 was amended in 2004 based on the recommendation given by Narayan Murthy Committee. Clause 49 regulations provide mandatory and non-mandatory guidelines. Mandatory guidelines deals with following elements of corporate governance

- Composition of Board of Directors
- The compositions and functioning of audit committee
Disclosures by the company
Compliance Certificate of a company with the provisions of Clause 49
Disclosures and governance regarding subsidiary companies
CEO/CFO certification of financial results

1.3 Definitions⁵:

- Corporate Governance is the system by which companies are directed and controlled (Cadbury Committee 1992) it involves the set of processes, customs, policies, laws and institutions affecting the way a corporation is directed, administered or controlled.
- SEBI Committee defines Corporate Governance as the “Acceptance by management of the inalienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It is all about commitment to values, ethics, business conduct and destination between personal and corporate funds in the management of a company.
- Corporate governance is 'an internal system encompassing policies, processes and people, which serves the needs of shareholders and other stakeholders, by directing and controlling management activities with good business savvy, objectivity and integrity – by Gabrielle O'Donovan
- Corporate governance is the relationship between corporate managers, directors and the providers of equity, people and institutions who save and invest their capital to earn a return. It ensures that the board of directors is accountable for the pursuit of corporate objectives and that the corporation itself conforms to the law and regulations. - By International Chamber of Commerce
- Corporate governance describes all the influences affecting the institutional processes, including those for appointing the controllers and/or regulators, involved in organizing the production and sale of goods and services. Described in this way, corporate governance includes all types of firms whether or not they are incorporated under civil law. – by Shann Turnbull
• Corporate governance describes ways of ensuring that corporate actions, assets and agents are directed at achieving the corporate objectives established by the corporation’s shareholders by Sternberg (1998).
• The approach of corporate governance that social, moral and political questions are proper concerns of corporate governance is fundamentally misconceived. Expanding corporate governance to encompass society as a whole benefits neither corporations nor society because management is ill-equipped to deal with questions of general public interest by Lipton and Lorsch (1992).
• Corporate governance is the process of control and administration of the company’s capital and human resources in the interest of the owners of a company by Hess (1996).
• Corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment by Shleifer and Vishny (1997).
• Corporate governance is the whole system of rights, processes and controls established internally and externally over the management of a business entity with the objective of protecting the interests of all stakeholders by Centre of European Policy Studies (CEPS, 1995).
• Corporate governance is the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies. The shareholders' role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place by the Cadbury Report (1992).
• Corporate governance defines a set of relationships between a company’s management, its board, its shareholders and other stakeholders by the OECD Principles of Corporate Governance (2004)^22.

1.4 Indian Corporate Governance:

The frame work of Indian corporate governance is consist of various legislation and regulations like the Companies Act, 1956, the Securities Contracts Act, 1956, the SEBI Act, 1992, the Depositories Act, 1996, Listing Agreement with Stock Exchange, 2000 etc..
All listed and unlisted companies in India are governed by the Companies Act 1956 and it is administrated by Department of Companies Act (now it is ministry of corporate affairs). This act was amended in 2000. It was more focused on modern principles of corporate governance principles. The power of Securities Contracts Act covers all types of tradable government shares, debentures, stocks and other forms of marketable securities issued by companies. The basic objectives of SEBI act are to protect the interests of investors in securities and promote and regulate the securities market. To empower the SEBI and to develop a well secured stock market. The act was amended twice in 1995 and in 1999. The listing agreement defines the rules, disclosure and processes that companies must follow to remain as listed entities on stock exchange.

1.4.1 Laws and Regulations:

The corporate governance framework in India primarily consist of the following legislations and regulations:

- **The Companies Act, 1956:** Companies in India, whether listed or unlisted, are governed by the Companies Act. The Act is administered by the Department of Companies Act (DCA). Among other things, the Act deals with rules and procedures regarding incorporation of a company; prospectus and allotment of ordinary and preference shares and debentures; management and administration of a company; annual returns; frequency and conduct of shareholders’ meetings and proceedings; maintenance of accounts; board of directors, prevention of mismanagement and oppression of minority shareholder rights; and the power of investigation by the government, including powers of the CLB. The companies act (Amendment) act, 2000 introduced significant changes to bring focus on the principles of modern corporate governance.

- **The Securities Contracts (Regulation) Act, 1956:** It covers all types of tradable government paper, shares, stocks, bonds, debentures, and other forms of marketable securities issued by companies. The SCRA defines the parameters of conduct of stock exchanges as well as its powers.

- **The Securities and Exchange Board of India (SEBI) Act, 1992:** This act established the independent capital market regulatory authority, SEBI, with the objective to protect
the interests of investors in securities, and promote and regulate the securities market. This act was amended twice in 1995 and in 1999 to clarify the ‘disclosure’ norms and further empower SEBI to protect the interest of investors and to develop a secured stock market.

- **The Depositories Act, 1996:** This act established share and securities depositories, and created legal framework for dematerialization of securities.

- **Listing Agreement with stock exchanges, 2000:** This agreement defined the rules, processes, and disclosures that companies must follow to remain as listed entities. A key component of this agreement is Clause 49, which states the corporate governance practices that listed companies must follow. These recommendations dealt with compensation and remuneration and conduct of the board members.

### 1.5 Corporation

The word “Corporation” derived from the Latin word Corpus. It stands for a body of people. These are the entities which carried on the business and it is the subject matter of legal rights. It was also found in Rome and Maurya Empire in ancient India. The corporation is formed under the state laws. It is considered as a separate legal entity which has certain liabilities and privileges like a natural person. There might be several reasons to form the corporation most of which were used to conduct the business. Most of them were chartered for specific purposes, such as banking. Corporation could only exist for a limited time, were not allowed to make any political contributions and could not own stocks in other companies. Earlier the ownership was divided among the few individuals who were also participated in management.

The process of corporate governance evolved with the beginning of corporatization of business since 19th century. Initially, corporate laws and rules for business administration in a state or country formed the basis of corporate governance which was transparent or unanimous. Gradually, with the rise of large trading houses and corporations, especially in US, and with increasing flow of public money to various corporate entities, right of individual owners and shareholders became an increasingly important issue in corporate governance.
1.5.1 Key Features:

- **Separate Legal Personality**
  A company has its own legal personality. Consequently it can be a party to contracts and the subject of rights and liabilities. Furthermore, the existence of a corporation may continue indefinitely unless and until it is liquidated.

- **Limited Liability**
  Starting point for this feature is the company’s responsibility for its own debts and liabilities. In other words, the shareholders share the company's profits, but they are not responsible for its losses. They are only liable to the company to pay up their share capital and have no further liability. So limited liability actually shifts the risk of business failure from the company's shareholders to its creditors. This appears to give the company's owners and managers too much of an incentive to take risks and can lead to an inefficient use of resources.

- **Separation of Management from ownership**
  The effective separation of ownership and control of management leads to an efficient growth of large public corporation. The investors are investing their money by purchasing the stock of the company and which entitles them to be part of the residual income of the firm after the all expenses have been deducted.
  - The right to stake in residual profit means that the shareholders are agrees to take the risk to sacrifice the residual profit if the expenses of the firm exceeds its income.
  - Investors are managing the risk of investment by investing money in diversified portfolio of firms.
  - Generally in small firm there are lesser amount of separation of ownership and control i.e. managers and owners are almost one and the same.
  - In family owned firms the owner normally don’t have required managerial skills to grow the business so they try to find the external sources for capital and skills to support this expansion.
• **Transferability**
  A share in a company carries rights against the company to receive dividends and (usually) to vote at shareholders meetings. A share can be transferred to a new holder and this transfers the associated rights and liabilities. Shares in a public company are usually traded on a stock exchange, facilitating transfer and making shareholding a more flexible kind of investment.

**1.5.2 Significances**:
Following are the few reasons identified by various research scholars, why corporate governance is so prominent in current situation.

• **The Worldwide Waves of Privatizations:**
  The root of privatization lies in the UK. Almost ninety percentage of EU privatization were proceeded in 1991. Together it since 1995 sixty percentage of privatization revenues also have been generated by Japan, Spain, Italy, Australia and France alone. The main use in privatization is that how privatized corporation should be owned and controlled. In UK the privatization at massive level attempted to reform the democracy of shareholder. While in many other countries the great care was being taken to transfer the control of privatized unit to large shareholders. The concerned for the choice of method for privatization was the governance issues. Shinn (2001) found that the role of state as a public shareholder in privatized corporation have been the essential source of motivation to change the worldwide corporate governance practices. Finally, the privatization have increased the role of stock market.

• **Pension Funds and Active Investors**
  The growth of contribution of fraction of employee pension funds have also increased the household savings has created the situation where the large in number and powerful investors are influence the corporate governance. It is a common asset pool that is meant to generate long term stable growth. These pension funds are plying more and more active role in worldwide corporate governance practices. It has led to development of the service industry that exercise votes for clients. Institutional investors are the one of the effective force behind the rapid revolution of the corporate
governance system. The continuing reforms in pension system and changing patterns of the saving will also likely to change the governance picture in near future.

- **Mergers and Takeovers**
The 1980s in US and 1990s in Europe, the wave of hostile merger and takeover have fuelled the debate on corporate governance. One of the largest cross-border hostile bid of $199 billion by Vodafone was the biggest ever to take place in Europe. It was noticeable that the social democratic administration in place at that time have not opposed the same.

- **Deregulation and Capital market integration**
The one of the reason behind the promotion of corporate governance rules is to protection of foreign investment in Asia and other emerging markets. The growth of equity capital and integration of world capital market have also been the reason to increase the interest of corporate governance issue. The fast growing companies in US and Europe are raising the funds from the diverse sources by cross listing on multiple exchange. This has also led to the culture of equity outside the US and Europe.

- **Series of Corporate Scandals and Failures**
The series of corporate financial scandals and corporate failures are evolving in the US. Corporates are manipulating the accounting results that enabled firms to overstate their earnings. Such cases normally happens during the economic downturn.

1.6 Approaches28:

1.6.1 Agency Theory
Agency theory refers to a set of propositions in governing a modern corporation which is typically characterized by large number of shareholders or owners who allow separate individuals to control and direct the use of their collective capital for future gains. These individuals, typically, may not always own shares but may possess relevant professional skills in managing the corporation. The theory offers many useful ways to examine the
relationship between owners and managers and verify how the final objective of maximizing the returns to the owners is achieved, particularly when the managers do not own the corporation’s resources. Agency problems arises due to the separation of ownership from control of corporations. Large number of shareholders with negligible shareholding have replace the earlier founding entrepreneurs who both owned and controlled their business. Better equipped professional managers run the business efficiently on behalf of them but they also have their personal interest and agenda that may not be aligned to the interest of the minor shareholders. Efficient managers can create wealth for their corporations, but its allocation may be adversely impacted by misappropriation for their private benefits. Board structure in this situation are favor of monitoring and assurance mechanisms, more number of independent director in board, whistle blowing process and so on.

Following Adam Smith (1776), Berle and Means (1932) initiate the discussion relating to the concerns of separation of ownership and control in a large corporation. However, the concerns are aggregated by Jensen and Meckling (1976) into the ‘agency problem’ in governing the corporation. Jensen and Meckling identify managers as the agents who are employed to work for maximizing the returns to the shareholders, who are the principals. Jensen and Meckling assume that as agents do not own the corporation’s resources, they may commit ‘moral hazards’ (such as shirking duties to enjoy leisure and hiding inefficiency to avoid loss of rewards) merely to enhance their own personal wealth at the cost of their principles.

Though the efficient separation of management control and ownership enables efficient governance of the firm, it also results in emergence of potential agency costs or risk for owners. There are two parties participates in agency relationship, one is principal party which delegates the decision making rights to another agent party. The agents who performs the service is specialist in decision making for that area. The agency relationship is not limited to owner and managers but it is wider than it i.e. consultant and clients or insured and insurer. The conflict of interest between managers and owners are generated due to passing the responsibilities of the decision making to managers. Many times it happens that the managers are not taking the actions and decisions which are most favor of owners instead of it they take the alternative strategic decisions which serve the managerial
benefits rather than the investors or owners interests. The agency relationships aids to increase the chances of managerial opportunism. The managers tend to seek the self-interest by means of cunning or deceit behavior. It is difficult to understand the managerial behavior because the reputation of manager is not the exact way to know their future behavior therefore it is not possible to understand which agents will act opportunistically. As a result of this the principal forms the governance and control mechanism.

1.6.2 Stewardship Theory Approach:
In this approach managers are assumed more than the exclusively self-interested, rational, economic individual focused on personal pecuniary benefits. This theory negates the goal incongruence assumption of agency theory. It believes that the non-pecuniary objectives and aspirations may motivate people in management like the need for achievement & recognition, the intrinsic satisfaction, respect for authority and the work ethic (Galbraith, 1967) Board structure in this circumstance favour inside dominated boards, fewer outside members, nonaligned independent directors and reduced focus on control with increased emphasis on contribution to the firm’s wealth creation efforts.
Parthasarthy (2007) has discussed four P’s of corporate governance in his book “Corporate Governance, Principles, Mechanisms & Practices”. The 4 P’s of governance are as follows:

People:
People are the heart of any corporate in general and corporate governance in particular. Equity, ethics and relationship are the parameters on which people orientation of corporate governance can be measured. Equity means fair and equitable treatment of all. Equity has two aspects—positive and negative. In positive sense, equity means same behaviours, award appreciation etc. to all on achievement of the objectives. In negative sense, equity talks about same extent and kind of punishment on commitment of an act of commission or omission of any misconduct or contravention of any rule or regulation. Equity also means equitable distribution of wealth among the people. Protection of human rights of people is also an important aspect of it.
Ethical practices of corporate of organisations include integrity, propriety and independence, transparency in operations and disclosure of information, anti-corruption
practices, non-money-laundering, and protection of intellectual property rights, non-counterfeiting, avoidance of harmful products, proper insolvency or closure process.

**Purpose:**
Another ‘P’ of corporate governance is “Purpose”. The purpose should be established, measurable, actionable and communicated. Different aspects of purpose are vision-mission and strategy. The vision-mission are decided based on unified and shared values of the organisation, stakeholders’ policies and organisation commitment. The strategy leads to strategic action plan, performance metrics, capacity building planning and strategic management team.

**Process:**
This ‘P’ of corporate governance includes process management. Process compliances and process innovation. The prices should be established, integrated, documented, automated, implemented and maintained. It has different aspects such as organisation management, resource management, and supply chain management, outsourced management, marketing management, risk and crisis management. The organisation has to comply with various rules, regulations, statutes and laws enforced by state and central government which includes compliance management. Independent assurance mechanism and whistle blowing. When certain things are going wrong or violating any norm, rule regulation or any act, the employees should have freedom to sound it off to the top management to take preventive action.

**Performance:**
Performance should be measured, analysed and communicated in order to achieve growth through efficiency. Efficiency can be segregated into different types as operational efficiency, asset or infrastructure efficiency and management process efficiency. Growth in any organisation brings in increase in income of organisation and stakeholder, increase in net worth or market share, expansion and diversification and increase in opportunities in stakeholders.
1.7 Corporate Governance Guidelines:

Timeline for various initiatives and enactment take place for corporate governance practices are given in Table 1.1. Table 1.2 shows the comparative picture of various corporate governance parameters in different countries i.e. India, US, UK, China, Japan, Australia.

Table 1.1: Timeline of Corporate Governance Initiatives and Enactments

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Initiatives and Regulatory Enactment</th>
<th>Country</th>
<th>Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>The Cadbury Report</td>
<td>UK</td>
<td>1992</td>
</tr>
<tr>
<td>2</td>
<td>Greenbury Report</td>
<td>UK</td>
<td>1995</td>
</tr>
<tr>
<td>3</td>
<td>Hampel Report</td>
<td>UK</td>
<td>1998</td>
</tr>
<tr>
<td>4</td>
<td>Ad hoc Task Force OECD</td>
<td>France</td>
<td>1998</td>
</tr>
<tr>
<td>5</td>
<td>Blue Ribbon Commission</td>
<td>US</td>
<td>1999</td>
</tr>
<tr>
<td>6</td>
<td>Information on the Company Law Review</td>
<td>UK</td>
<td>2001</td>
</tr>
<tr>
<td>7</td>
<td>The Company Law White Paper</td>
<td>UK</td>
<td>2002</td>
</tr>
<tr>
<td>8</td>
<td>Sarbanes Oxley Act</td>
<td>US</td>
<td>2002</td>
</tr>
<tr>
<td>9</td>
<td>The Higgs Review</td>
<td>UK</td>
<td>2003</td>
</tr>
<tr>
<td>10</td>
<td>The Smith Report</td>
<td>UK</td>
<td>2003</td>
</tr>
<tr>
<td>11</td>
<td>The Tyson report on the Recruitment and Development of Non-Executive Directors</td>
<td>UK</td>
<td>2003</td>
</tr>
<tr>
<td>12</td>
<td>The European Commission’s Action Plan for Company Law and Corporate Governance</td>
<td>UK</td>
<td>2003</td>
</tr>
</tbody>
</table>
Table 1.2: Comparative Status of Corporate Governance Parameters in India:

<table>
<thead>
<tr>
<th>Parameter</th>
<th>India</th>
<th>USA</th>
<th>UK</th>
<th>China</th>
<th>Japan</th>
<th>Australia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Board Composition - Independent Directors</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
</tr>
<tr>
<td>Required Separation of chief executive and chairman of the board roles</td>
<td>X X</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
</tr>
<tr>
<td>Compensation Committee - Independent Directors</td>
<td>X</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
</tr>
<tr>
<td>Code of Ethics for senior financial officers required</td>
<td>Y</td>
<td></td>
<td></td>
<td>Y</td>
<td>Y</td>
<td></td>
</tr>
<tr>
<td>Audit-Committee Authority to engage outside advisers</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Management required to forfeit bonuses or other compensation if a restatement occurs</td>
<td></td>
<td>Y</td>
<td></td>
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<tr>
<td>Management required to certify internal control structure and/or disclosure controls</td>
<td>Y</td>
<td>Y</td>
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</tr>
<tr>
<td>Restriction on loans to officers and directors</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
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<tr>
<td>Required rotation of audit partners</td>
<td>$</td>
<td>Y</td>
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</tr>
<tr>
<td>Rules regarding disclosure of off-balance sheet transactions and contractual obligations</td>
<td>$</td>
<td>Y</td>
<td>Y</td>
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<tr>
<td>Rules regarding disclosure of forward looking earnings guidance</td>
<td>Y</td>
<td></td>
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</tr>
</tbody>
</table>

X – Non Mandatory, XX – Encourages/ Prescribes alternate, $ - Under Consideration

Source: Deloit Haskins & Sells
1.7.1 Cadbury Committee Report

A committee under the chairmanship of Adrian Cadbury (UK) in May 1991 has first ever organized attempt to establish the set of guidelines for governance. It was concerned about the minority investors’ confidence in fiscal reporting and the ability of the auditor to carry out their jobs. Committee had also contemplate on how governance can be improved by involving independent directors in the board, separating the roles of chairman and CEO and establishing audit committee of a boards for all companies listed on the stock Exchange.

It was the pioneer initiatives and was/is being used as the reference point for the many other corporate governance guidelines initiated by many other countries. The report includes the structure and responsibilities of boards of directors, role of auditors, and right and responsibilities of the shareholders. The code of Cadbury was the general guideline for the company which provides the lot of room for companies to develop their own governance practices. The code was voluntary in nature, companies has to provide the information in which area they are compliance with guidelines and give the explanation on gaps from the code, if any.

1.7.2 Combined Code:

The main focus of the Cadbury Committee was on financial aspects of the governance while some issues related to general governance were still left. The committee under the chairmanship of Richard Greenbury of Marks and Spencer recommended few issues in their report in 1995. The main concern for the committee was about the size of directors’ remuneration and their inconsistent and incomplete disclosure report. These two aims were being achieved by the presence of the remuneration committee comprising of the independent directors and the adoption of performance measure (Mallin 2007). In 1995, Ronald Hampel (ICI plc.) committee had reviewed the implementation of code of previous committer recommendations. Moreover the committee had also suggested that the company should also be concerned for the other stakeholders like employees, customers, lenders, local community etc. Additionally they emphasized the role of the institutional investors in improving governance practices. The combined code 1998 has two parts—one aimed for the companies and other for institutional investors.
1.7.3 Sarbanes—Oxley Act 2002:
The large corporate financial frauds and failures of corporate governance in high profile companies like Enron, WorldCom, and Tyco happened in the US grab the attention of corporates, academician and government. Paul Sarbanes and Michael Oxley established a new law for regulating corporate governance referred as the Sarbanes-Oxley Act 2002 (i.e. SOX Act 2002). Smith and Walter (2006) notes that the act let to tightening rules and enforcement actions on public corporates and increases the burden to adapt new and costly compliance standards to review their own corporate governance practices. It has strengthen the role of audit committee and established new standards for auditor independence. Beside this it has increased the CEO accountability for financial statements. Additionally it has also tightened the punishment and penalties for fraudulent acts or white collar crimes. After SOX was passed Charan (2005) found that there were hard to find the qualified directors and he has also observed that the candidates would like to serve the fewer boards because of the greater time demands and some would turn down the opportunity due to fear of legal liability.

1.7.4 Summary of Reports:\textsuperscript{22}:

**Cadbury (Cadbury Report, 1992):**
- Aimed to improve information to shareholders, reinforce self-regulation and strengthen auditor independence.
- Produce the Cadbury code of Best Practices of corporate governance.
- Recommend that:
  - The boards of directors should report on the effectiveness of companies systems of internal control.
  - The service contracts of directors should not exceed three years without approval by the shareholders.
  - Each listed company should establish and audit committee of at least three non-executive directors.
**Greenbury (Greenbury Report, 1995)**

- Aimed to provide an answer to the general concerns about the accountability and level of directors pay.
- Argued against statutory control and for strengthening accountability by the proper allocation of responsibility for determining remuneration of directors, the proper reporting to shareholders and greater transparency in the process.
- The code of best practice produced by Greenbury Code was divided into four section:
  1. Remuneration committee
  2. Disclosure
  3. Remuneration policy
  4. Service contracts and compensation
- Recommended that UK listed firms should implement the code as set out to the fullest extent practicable; that they should make annual compliance statements; and that investor institutions should use their power to ensure that best practice is followed.

**Hampel (Hampel Report, 1968):**

- Advanced the Cadbury Report.
- Produced the combined code
- Recommended that the companies that do not already have an internal audit function should from time to time review their need for one.
- Introduced the combined code that consolidated the recommendations of external corporate governance reports.

**Turnbull (ICAEW, 1999):**

- Provided guidance to assist companies in implementing the requirement of the combined code relating to internal control
- Recommended that where companies do not have a internal audit function, the board should consider the need for carrying out and internal audit annually.
• Also recommended that boards of directors confirm the existence of procedures for evaluating and managing key risks.

1.7.5 CII Code Recommendations (1997):  
After Cadbury Committee Report in UK many countries woke up and found the need for improving corporate governance regulation in their countries. Great concern was for the protecting the rights of minority shareholders. The confederation of Indian industry (CII) took the first such an initiative in 1996 to develop the code of corporate governance to guide the Indian companies. Aim of this code was to promote and develop the code which makes the system which protects their investors, which are more transparent and having greater disclosures and transparency in decision making. Apart from this the overall aim of good governance is to satisfy the need of all the stakeholders at optimum level. Under the chairmanship of Mr. Rahul Bajaj, the CII had set up a National Task Force that included the members from the divers industry, legal profession, and academicians. The task force prepared the report in April 1997 which was then publicly debated and suggestions were incorporated from various expertise and finally the guideline was published in April 1998. Followings were the major recommendations of the report.

• A single board structure
• Inclusion of independent directors in board (one third if the board chair is non-executive and half if the chair as also act as a managing directors
• Maximum 10 directorship can be represented by a director
• Non-executive directors should be financially qualified and should take more responsibilities in company affairs
• Attendance of the directors in board meeting should at least 50 percentage and reappointment of the director must be done based on the previous attendance.
• Prime information related to the company should be placed before the board.
• The audit committee must be constituted with the non-executive directors and should be financially qualified to understand the financial terms and transactions.
1.7.6 Birla Committee (SEBI) Recommendations (2000): 

In 2000 the committee chaired by Kumar Managlam Birla have further contemplate on contemporary governance practices and evaluate the same and given some important reformation for effective governance practices. It gives more emphasis on non-executive members in board. As the CII codes were the voluntary in nature from the industry side therefore SEBI has taken the initiatives to create and regulate the realm for corporate governance for the Indian Companies. While a number of guidelines for corporate governance were available in US, UK and other developed countries, but it doesn’t make any sense for the heterogeneous industry structure and environment in India.

It appointed a committee under the chairmanship of Shri Kumar Managlam Birla to prepare guidelines that can be executed for the corporate governance practices of the Indian companies. The major recommendations of the committee are incorporated in the Clause 49 agreements of the listing between companies and the stock exchange which forms the basis of corporate governance in India. Report is classified under the mandatory and non-mandatory guidelines.

Few important mandatory guidelines are as follow.

- Not less than 50 per cent of the board should be non-executive directors (at least one third of the board should be independent directors in case of non-executive chair and half for the executive chair)
- Nominee directors can be appointed by the financial institution only on selective bases and where it is essential.
- Under the chairmanship of an independent director, the Audit committee should be form with majority independent directors with financial qualified or literate.
- The directorship of the directors on the board is maximum limited to 10 committees and can act as the chairman of the maximum five committees.
- Management has to disclose all the financial and commercial transaction to the board
- The board of directors should decide the remuneration of non-executive directors.

Apart from it, report also suggest that companies should have a remuneration committee to set the remuneration packages for the executive directors. The committee should be chaired by an independent director and all other members must be non-executive directors.
A company with an executive chairman should have half independent board members and for non-executive chairman number limited to one third of the board. An individual can have maximum of 10 directorships and 5 chairmanships. This committee is also accept the number of audit committee member three but also stress that at least one member must have financial and accounting knowledge. The committee should meet at least thrice a year, one before finalization of annual accounts and one necessarily every six months. Additionally they recommended the requirement and importance of remuneration committee to decide the remunerations packages for executive directors. This committee must chaired by an independent director and all remuneration information must be disclosed in an annual report. For Disclosure and Transparency it forces that disclosure list pertaining to “related party” transactions. A mandatory Management Discussion & Analysis segment of annual report should also be disclosed. They should also informed board of all latent conflict of interest situations. Further share performance must communicate quarterly to shareholders. The share transfer power of a company should delegate to the share transfer agents or officers or committee or registrar.

1.7.7 Naresh Chandra Committee Report (2002):
After the failure of large corporate companies in US and also enactment of Sarbanes-Oxley Act 2002, in India the Department of Company Affairs (DCA) appointed a committee under the chairmanship of Shri Naresh Chandra to review the governance issues related to appointment of auditor, fees of auditors, rotation of audit firms or partners and make the crucial role of independent directors on the board.

1.7.8 Narayan Murthy Committee (SEBI) Recommendations (2003) 6:
As the governance standards have been evolving, it was necessary to evaluate the scope of the current governance practices and further improving it therefore SEBI constituted a committee under the chairmanship of Narayan Murthy to review the existing governance practices and recommend the further improvement required for good governance. The recommendations from the Narayan Murthy Committee are more qualitative than quantitative. They have suggested the requirement of training for the board members. Further they recommended that there should not be nominee directors. All directors should
be elected by shareholders with same responsibilities and accountabilities. They have clarified that the compensation of non-executive directors should be fixed by board and ratified by shareholders. For an audit committee they emphasized the financially literacy of the members and also introduced the Whistle Bowers policy. Further, it suggested that audit committee must approve all “Related Party” transaction. The audit committee should be the responsible for the appointment, removal and remuneration of chief internal auditor. The committee has also recommended that the subsidiaries board should also follow all the common rules that Parent Company follows. The subsidiaries company must have an independent director of the parent company. Additionally it also recommended that the management should follow the disclosure and transparency policy. For that if there are any deviation from accounting standards they should explain and justify the deviation and give the reason for it with required comments of auditors. Committee had given the additional recommendation for IPOs disclosure, the company should inform the audit committee about the category-wise use of the funds. The audit committee should advise the board for actions in this matter.

1.8 Models$^{1, 13, 31}$:

Across the world, there are several different models of corporate governance in practice. It is the reflection of the ways organizations are funded and secondly reveals the control imposed by legislation or an external regulator. Taking a worldwide view, governments have created many different approaches to regulate companies and corporation in order to protest assets, earning capacity and reputation of the organization.

1.8.1 Anglo Saxon Model (Anglo American):
Anglo Saxon model is based on the corporate objectives set by the owners of the organization. It applies to the United Kingdom and United States. The shareholders are the primary stakeholders to whom the organization is accountable and the internal performance and external accountability is geared towards the achievement of these objectives. With increased foreign ownership and global competition, there is a slow trend towards the adoption of the Anglo- American governance approach. The Anglo-Saxon model of
governance is characterized by widespread shareholding of equity and stress on financial objectives by the companies. A typical company is one that is represented by a large number of shareholders at arms-length (hence the model is sometimes referred to as the “outsider model”). The objective of the governance system is to set up rules and guidelines so that board members and executives work to maximize shareholder wealth. Shareholders are viewed as the “risk takers” of the company.

1.8.2 Continental mode (Franco German Model):
It views a firm as a collective entity that has responsibilities and duties towards key stakeholders, with shareholders perceived to be only one group of such stakeholders. It applies to Germany and other Continental countries. It represents a well-developed stock market, strong investors’ protection, disclosure requirements, shareholders activism and takeovers but may suffer from short-termism by both managers and investors. The Rhineland model is characterized by a significant holding by a parent company and outside shareholders represent a smaller portion of the equity. This model is based more on a “socially correct” market economy. In fact, individual companies within a particular company group can be viewed as an “internal market”, both in terms of financial and other resources such as labor and intellectual properties. Hence, cooperation is stressed. Shareholders in this system are generally stable partners and relatively longer-term investors as compared with the Anglo-Saxon model. Shareholders are viewed as “partners” of the company.

1.8.3 Japanese Model:
Japanese industrial structure is based on a network of supplier and buyer companies (“Keiretsu”). Keiretsu are known for their extensive cross shareholding among members and their main banks. Organizations have long term and stable relationship among firms and the banks that finance them. It may suffer from collusion and favor entrenchment by managers.
From the perspective of Japanese definition the corporate governance is concerned with the code and conduct of the board of directors who are selected on behalf of the investors. The directors are authorized to govern the organisation and also monitor and control the
management in order to enable the effective management to protect the rights of investors. They are the major administrator in the organisation to ensure that it is always endeavoring to maximize corporate value in the long-term for the shareholders and always prepared to be accountable for its actions to all the stakeholders.

1.8.4 The Family Owned Company Model:
Another type of corporate governance model run by family owned business, this is prevalent in Asian and Latin American countries, where companies owned by families often dominate the market. In these countries, it is not unusual for a small number of powerful families to control a majority of public companies. The notion of financial transparency that dominates the framework of corporate governance under the Anglo-American model is very difficult for family owned companies to accept and operate with. This business model views the transparency and disclosure norms of the Anglo American model as exposing the core business financials and strategies to others, which would mostly benefit the competitors and regulators, with few tangible benefits to the organization.

1.9 Board:

The board of directors (BOD) are the ultimate responsible body for the governance of a firm. It is the statutory requirement for a company to a board consist of executive and non-executive directors. The BOD holds the fiduciary responsibility to act behalf of the investors. They also have to act in interest of the shareholders. The firms are established on the laws proposed by the state/federal government. In general practices, the states are competing with each other to attract the large corporation to establish in their state therefore most of the corporations are incorporated under the laws governed by the state. While the few federal rules and regulations like SEBI acts, Companies act 1956 etc. are applicable to all firms irrespective of their state of incorporation. Most of the firms in India are incorporated under the Companies act which is applicable to all the states. A companies have the characteristics of immortality means it is a stable form of the organisation which may not affected by the change in composition of its members. It is the artificial individual created by the law. It is also considered as the separate legal entity which is distinct from
its members. The limited liabilities and easy transferability of ownerships are key feature of company to mobilize the funds from many investors. The governance of large organisation is much complex job and requires the constant attention. The outside directors may know the little about the business—too little on the whole to be useful as outside director.

1.9.1 Purpose:
The purpose of the board of the firm is to ensure the prosperity of the firm by directing the affairs of the company and meeting the expected interests of its shareholders and other related stakeholders. The investors of the company gives power to the board of directors to act on behalf of them. Many time the role of executive/whole time directors is entangled with their role as members of the board. Their responsibilities as the executive director is differs from the members of the board. The confusions may also arise when the one of the board members holds significant stakes of the firm. It may divert the attention of the board from their prime objectives. At this moment the role of chairman becomes the crucial to remind the board that the principal aim of the board not only to meet the interest of the shareholders but to act in the best interest of the company at all times. The matter gets more complicated when the chairman holds the large stake of the firm. Normally this situations are found in family owned and promoted firms in India. In this situation board has to rely on independent members of the board who reminds the boards of its legal and fiduciary responsibilities. This independent members is known as the lead independent directors of the board. The ultimate aim of the board is to persisting the prosperity of the firm.
The executive directors should clear roles, responsibilities, duties and purpose of the member of a board. They should also gone through the memorandum and article of association of the firm where they are serve as the directors. And finally they must successfully isolate their roles as the executive management roles to the directors of the board. The board is first accountable to the shareholders. The duties of the board is derived from the rules, regulations, traditions, customs and contemporary governance practices.
1.9.2 Boards as Unitary Board and Two Tier Board:
Supervisory board members are the representatives of the shareholders. They are elected by the shareholders in the general meeting of the board. Few members are also nominated by the employees and represents the employees in the board. It control the direction of the firm and oversees the establishment of operating system and information system by the board of management. Members of the management board are appointed by the supervisory board. Management board run the business and provides the required financial information and other reports to the supervisory board. They also implements an appropriate system for effective management of the business.

- All executives are made up of all full time executive directors.
- Majority executives—board is dominated by the executive directors.
- Majority non-executives
- Two-tier (Supervisor Board and Management Board)

1.9.3 The Role, Duties, and Responsibilities:
The members of unitary board are elected by the shareholders at a general meeting. In general practice the shareholders are approving the nomination made by the board or the nomination committee of the board. Most of the developed and developing countries follow the Anglo-American system of a unitary board structure. While the European countries follow the two-tiered/dual-board system made up of supervisory and management board. As per the Companies Act 1956 (Section 252), the board of a public limited company should made up of at least three directors and private limited it is minimum of two. The company has to specify the limits of maximum and minimum number of directors in the article of association and within that limits it can increase or decrease the number of director. It raise the number beyond the limit, a company needs to take approval from the central government. The governance related matters of company are being administered by the board. By rule the whole power of executions are vested upon the board but in practice, the board delegates this power to managing director i.e. Chief Executive Officer of the company. The board have the final authority to appoint, change and remove the management whenever it is necessary.
Role of the board is subject matter of kind of needs of the organisation and context in which the board is functioning. In some companies the, board plays the active role in business activities particularly in the formation of strategy. While in some companies the role of board remain very passive. The role is limited to compliance to the laws only i.e. just for statutory requirement. Charan (2005) calls this kind of board as the ceremonial boards. Generally the role of the board is determined by the context (kind and nature of industry, economic condition, globalization pressure, organisation culture etc.) in which the company operates. The role of supervisory board is to decide the business policy and strategy for future direction of the company. This board is responsible for appointment, remuneration and dismissing of management board. It approve the profit distribution proposed by the management board. It also participates in the preparation of financial reports and ensure the integrity in accounting and reporting system of the firm.

1.9.4 Evolution of Board:
The enactment of Sarbanes-Oxley Act of 2002 is a revolutionary event for the corporate governance scenario. Ram Charan (2005) describes the three stages of board evolution (the ceremonial board, liberated board, and progressive board)

- **Ceremonial Board:**
  It performs only compliance role. The role of directors is limited to attending the minimum required board meeting and gives the consent to the resolution proposed by the management. The prospective stakeholders many not know them or their contribution. In many cases of high profile scandal the role of board was limited to ceremonial category.

- **Liberated Board:**
  After the Sarbanes-Oxley act the most of the board left their traditional style and firm seeks the more and more contribution from expert members of the board. The directors are also willing to take active participation in the board proceedings. The momentum of shareholder activism, and pension funds reforms had also accelerate the evolution of new style of governing the board.
• **Progressive Board:**
  This kind of board is governing in way to get the competitive advantage for the firm. The board works in a team, encouraging discussion, and debate without breaking the harmony of the team. Garratt (1996) defines it as the learning board. The members of the board are involved in policy formulation and strategic implementation in order to acquire the return above the expectation of investors. Generally the roles of all executive and non-executive directors remain same.

1.10 **Board Committees**\(^{12}\):

The whole board is responsible for the overall corporate governance, still it may not be possible that everyone can involve in various governance activities. Carter and Lorsch (2004) advised that the governance activities should be divided into various board committees so it can accomplished more in their limited time. They also identified that for complex matters, the whole board approach may come to be more critical because in on paper everyone is responsible but in practice no one takes responsibilities. At the same time it is difficult for every directors to understand all the technical details.

In the area of auditing, financial position of the firm require specific qualification and experience. It may not be possible for every directors to understand and analyze the financial reports and transactions. Therefore boards have started a practice to form various committees intended to attain specific purpose. Moreover, few committees are permanent while some are formed to meet temporary needs and some are mandatory by regulatory body.

In general firms have following committees—

- Audit committee
- Compensation/Remuneration committee
- Nomination committee
- Shareholder/Investor grievance committee
- Special committees like managing committee, risk management committee, committee of directors etc.
In India Audit committee and investor grievance committee are mandatory under regulatory frameworks. In US remuneration and nomination committees are also mandatory. Banking firms always constitute a risk management committee to administer the management of risky exposure of banks. Every committee must constituted of directors only and each of these committees must have a chairman. The roles and responsibilities of the various committees are explained below.

1.10.1 Audit Committee:
Audit committee is mandatory under almost all regulatory frameworks. It also insisted that the committee should be constituted of independent directors. According to Clause 49 the committee should have minimum three directors and majority of them are Independent directors. It also assert that one of the directors must have enough knowledge of finance and accounting. In India SEBI listing agreement guidelines necessitates that every listed firms should adopt an audit committee charter. The main function of committee is to advise, appraise and report the board about internal audit system, audit issues, audit process and various other systems of internal controls. The committee should meet at least four times in a year (Clause 49, 2006).

1.10.2 Compensation Committee:
This committee decides the remuneration to be paid to the managing directors, other fulltime executive directors and part time non-executive directors. The committee establish the compensation criteria to attract and retain expertise and talent within the firm. The board recommends and shareholders give their final approval in general meeting about proposed remuneration package. Remuneration committee in India is not mandatory while it is mandatory according to Sarbanes-Oxley Act.

1.10.3 Nomination Committee:
The principal aim of committee is to appoint the new directors in case of retirement of existing members or if existing member may not want to continue the directorship. Directors are also need to appoint if the company wants to expand the board. It administer process of identification, screening and review of potential members to serve as executive,
non-executive and independent directors. Committee recommend the prospective members to the board for the final approval and appointment. It is non-mandatory in India.

1.10.4 Shareholder Grievance Committee
According to clause 49, it is mandatory to have an investor grievance committee of the company. It oversee the complaints and grievances of the shareholders regarding non receipt of shares, debentures, dividends, financial reports, interest warrants, delays in transfer, and issue of duplicate certificates. It also look after the code and conduct of the company related to insider trading. It is constituted of the executive and non-executive directors.

1.10.5 Risk Management Committee:
According to SEBI guidelines, it not mandatory for a firm. While RBI and other banking regulators insist that the banks and other financial institution which are exposed to various risks are expected to have a risk management committee. Some non-financial companies like Infosys have also constituted this committee chaired by independent director. The committee is responsible for review and approval of disclosure of risk in public documents and disclosure statements.

1.10.6 Special Committees:
Many companies are also form the special committees for the special purpose. They may have committees like disaster management committee, project committee, investment committee, merger and integration committee etc. The tenure of the committee depends on the kind of the requirement. The terms and references for such special committees are being available once they are created.

1.11 Board Composition:

Scholars and practitioners have often wrestled with questions relating to board composition, size, demographics, and so on, and their influence on corporate performance and behavior. The best that can possibly do is to work towards an appropriate board, in
terms of its size, profile, competencies and other criteria in the context of the company’s best perceived needs. Every incorporated company should have a forum for its governance in most cases this would be a board of directors or board. The directors are fall under the different categories, such as independent directors, non-executive directors and managing directors. Sometime non-executive directors who may independent or who may be nominees or appointees to represent discrete constituencies. The aim of board of directors is to protect the equity of the firm and to add value to the company and to maximize the return on investment of owners i.e. investors. The company laws has established the roles and responsibilities of the board of directors. These involve defining strategies, electing and removing CEO, supervising management and naming and removing independent auditors. The board of directors should approve the company’s code of ethics.

1.11.1 Executive Directors:
- Managing directors is a director who, by virtue of an agreement with the company or of a resolution passed by the company in general meeting or by its board of directors or, by virtue of its memorandum or articles of association, is entrusted with substantial powers of management which would not otherwise be exercisable by him, and includes a director occupying the position of a managing directors, whatever name called, and whether under a contract of service or not. (Section 2 (24), Companies Act, 1956).
- Managing director shall exercise his powers subject to the superintendence, control and direction of its board of directors.
- Non-executive directors are the board members who are not the full time employee of the company, but are not independent.
- Whole time director has not been specifically defined in the companies act but section 269 explains a directors in the whole time employment of the company is the whole time director.
- The position of whole time director and managing directors are differs in terms of hierarchical terms and in terms of the content of delegated authority. The managing director possess the substantial power of management while the power of whole time director is limited to certain operations, function or a geographical areas.
1.11.2 Non-Executive Directors:

- In many developed countries the non-executive directors by definition are largely also independent directors but the Indian listing agreements distinguish between independent and non-independent non-executive directors.
- These are the members of the boards other than the whole time directors. It includes independent, nominee, ex-officio and constituency directors. The number of non-executive directors are the subject matter of company size and the complexity. Number is also limited by their time commitments to their personal and professional obligations and any association with other company boards.
- Their holding directorship in fewer companies helps the company to get the benefit of their knowledge and experience and adequate attention from them.
- Since all board directors have equal legal responsibilities but it is their independence of judgment that distinguishes the contribution of outside directors in board deliberations and decisions.
- They are not salaried directors in the companies but they are getting the remuneration for sitting on the board.
- Few of the important roles of non-executive directors on the board are as follows
  - They should bring an independent judgment to bear on issue of strategy, performance, key appointments and standards of conduct.
  - Board should be free from any businesses, or other relationship (apart from their director’s fees and shareholding) that could materially interfere with the exercise of their independent judgment.
  - They should be appointed for the specific terms and re-appointment should not be automatic.
  - They should be selected through a formal process and both, this process and their appointment, should be a matter for the board as whole, operating through its nominations or governance committee where one is in place.
- Company can have a lead independent director (LID) who will chair all the meetings of the independent directors. Recently few boards are encourage the separate meeting of independent directors without the presence of other members of the board. The
decisions and inputs from this meeting are conveyed by the lead directors in full board meeting.

1.11.3 Nominee and Ex-Officio Directors/ Institutional Nominees:
- They are the distinct sub-group of the non-executive directors.
- Nominees are senior full time employees of the nominating organisations but besides it they devotes their time to the affairs of the companies of which they are nominee directors.
- Many institutions are investing in the firm through equity of by lending to the firm. These institutions protects their interests in the firm by nominating the representative directors i.e. nominee directors on the board. Investment banks, venture capital firms, mutual funds, development financial institutions are normally investing in the companies.
- Under many regulations they are consider as independent directors irrespective of their holdings.

1.11.4 Promoter Nominee Directors:
They are belongs to the group of promoter or their allies. They may or may not hold the substantial stakes of the firm. In firm they are expected to strengthen the hands of promoter in the board room. Gupta (1998) suggest that the nominee directors can effectively contributed in board by improving the decision making process of the board.

1.11.5 Constituency Directors:
Constituency directors are those who are appointed to the board of the company from a particular constituency, such as workmen or small shareholders of the company and so on still their fiduciary responsibility extended to all the shareholders of the company and is not limited to the particular constituency he represents.

1.11.6 Composition of the Board and Related Issues:
- The board of directors is a committee which is elected by the shareholders of a limited company. The board is responsible for the policy of the company.
The composition of the board of directors refers to the number of directors of different age, education, experience, gender etc. who are participating on the board.

The board of a company must have an optimum combination of executive and non-executive directors will not less than 50 percent of the board comprising of non-executive directors. The number of independent directors should be at least one third in case the company has a non-executive chairman and at least half of the board in case the company has an executive chairman.

1.12 Independent Directors:

The collapse of high profile number of large corporations such as Satyam, Enron etc. while performing the governance practices has raised many issues regarding good governance mechanism. The independent directors are one of the important mechanisms for the good governance practices in an organization. In India two third of the companies are family owned and therefore presence of independent directors on the board is very important to protect the rights of minority investors and other stake holders. Independent directors with independent thoughts and action may lead to have a constructive value addition for the firm of conduct for them. The diverse opinion of the corporate experts, government bodies and industry apex bodies is the need of the hour to make one that is easy to implement.

1.12.1 Needs:

Economic crisis (2008) in America has raised many questions about the governance practices of the various corporate companies. World financial crisis and public pressure on private companies in specific areas were brought in critical aspects in corporate governance practices in most part of the world. Increase in white collar crime suggests that even highly qualified representative may not provide assurance for good governance as they tend to trust and provide blind support to the promoters. Presence of independent directors on the board of the company plays vital role for the good corporate governance. It plays very significant role in various corporate decision-making of the board like executive remuneration, audit function, merger-acquisition, succession planning, etc. All the listed companies need independent directors as corporate governance compliances.
In India more than 60 percentage of the listed companies are promoter driven companies so it becomes more crucial to understand how they find independent director? Is it based on individual connects and judgments or based on nomination process and thoroughly analysis? Are they appointed for the specific purpose or only for the sake of governance formalities, merely to abide by the law in words but not in its true spirits? The notion of independent director is to have truly independent persons of independent mind with required skills, experience and knowledge who can challenge the actions/decisions that are against the benefits of minority investors and other stake holders.

1.12.2 Picture of Indian Corporate:
India is the country where the industries composed of the lots of small and medium scale enterprises, listed/unlisted limited liabilities companies and global companies so it is difficult to have the common laws of corporate governance that can be applicable to all the firms. In India Clause 49 is applicable for all the listed companies as a listing agreements while government provides additional voluntary compliance guidelines that can be followed by any corporate companies. If any entity cannot complied with the governance guidelines then they need to explain in where/ why they are not complied and give the explanations for the same to the stake holders.

In India Ministry of Corporate Affairs (MCA) administers the basic acts i.e. Company Acts and other professional bodies like Institutes of Chartered Accountant, Institute of Cost Accountant, Company Secretary Acts, Limited Liabilities Partnership Act etc. Initially it was the department of the company affairs but after the series of corporate fraud in India and also in the overall world it comes in light and have taken several initiatives to monitor the governance practices in company. Initially it was focusing on the structure of the company now it realized the importance of corporate world that is reason now we have separate Ministry of Corporate Affairs which make/ change/erase the required low, rules and codes for the corporate.

In India Promoters or Promoter groups possesses the large shareholding and most of the management decisions are dominated by promoter. Therefore, the truly independent director should be independent from the promoter but in India more than 70 percentage independent directors appointed by the promoter and most of them are home directors. That
is why the appointment of independent directors is very critical in India. Prime database on statistics of independent director\(^1\) in India suggests that—in India there are 6443 independent directors holds the positions on the board out of which 2213 belongs to listed companies. Study shows that the only 2.5 \% women hold the position of independent director. Statistical reveals the few interesting observations like 198 directors are not even graduates, 3500 are graduates and 245 below the age of 35 and 18 below 25 including 18 years. SEBI doesn’t required any qualifications or experience to become independent directors on the board.

Listed companies are raising the funds from the public money so they must have independent director to protect the rights of minority investors and other stake holders. Recently parliamentary standing committee has submitted the bill. It states that 2 percentage of profit should kept for the corporate social responsibilities and it would applicable to the companies which meets certain criteria in terms of specific turnover, assess or profit for first three year etc. The notion of CSR is old in India but the low is new for the Indian corporate. Companies which generate the revenues from the community need to understand their ethic responsibilities to preserve and protect the community in term of CSR. CSR is not a charity but it is more than that because it creates positive brand image in mind of the stake holders so it is a win-win situation for all. If any company wants to exist in the market it has to earn the right exist in market then and then it earn for the stake holders.

1.12.3 Roles\(^15\):

As mandate by clause 49 (Section 2 /45) the independent director of a company is a non-executive director who does not have any material relationships or transactions with the company, its promoters, senior management, holding company, subsidiaries and associated companies. He may receive the remuneration of director. He should not be directly or indirectly link with companies as partner, supplier, vendor or customer of the company. At the same time he should not have a substantial shareholding of the company.

Higgs states that independent director is considered as independent when the board determines that the directors is independent in character and judgment and there are no relationships or circumstances which could affect or appear to affect, the director's
judgment. Greater number of Independent directors on board were result in improved firm performance (Padmini & Vasanthi, 2011) while powerful executive directors i.e. Duality roles, Promoter executive or executive being only the board manager did not have a detrimental effect on performance (John & Jackling, 2009). Sarkar & Sarkar (2009) concluded that the multiple directorship by independent directors positively correlated to the firm performance but multiple directorship by inside directors are negatively correlated to the firm performance. Carter & Colin (2004) estimated that the time to be devoted by any outside director for a company from about 80 hours for a stable and satisfactory company situations and industry complexity to 320 hours for a challenging company situations and industry complexity where the board plays the role of pilot. Apart from the above Agrawal & Knoeber (1996) have found that greater proportions of outside directors has a negative impact on the performance of the firm i.e. high proportion outside directors may result in lower financial performance. Bhagat and Black (1999) had also found negative correlation among proportion of outside directors and corporate performance.

1.12.4 Significance:

The role of board is to maximize the total value for the investors, customers, employees, government, society and other stake holders for that a company has to earn the revenues that is more than the expectations of the owners i.e. shareholders then and then it can satisfied the need of other stake holders. It is also known as the above average return i.e. returns more than the investors expected risk /return.

Role of Independent directors is of two fold i.e. as a strategic advisor to the corporate and at the same time protecting the rights of minority shareholders and other stake holders. As a strategic advisor he must have sufficient skills, experience and knowledge to accelerate the growth of the company. He must have some academic experience so at least they can read and understand the financial terms and transaction. Shareholders should assured that they are getting the best possible people to run their company.

They should provide the products and services more than the expectations of the customers i.e. worth more than the customer pays for it and provide the opportunities to the employees to be more productively in their job. The ultimate responsibilities of the independent
directors is to monitor the company’s business affairs and governance compliance with the
laws, shareholder agreements, governing documents and articles of the incorporation.
Independent directors play very important role while selecting, compensating, overseeing
and planning for the succession of the CEO. Failure in corporate governance is not only
the issue of government or companies but it is really the issue of the public morality.

1.12.5 Limitations:
There might have number of arguments for the role of independent directors at time of any
financial fraud by a company. In most of the cases it found that presence of independent
directors fails to assure the roles given to them. Should we totally rely on independent
directors for the good governance or laws, government ministry, regulatory body, industry
apex body has also need to do something. Following could be the probable reason why
independent directors fail to perform their roles and responsibilities.

- Independent directors may have limited roles in company affairs or may take
  limited interests in it.
- May not be sufficient qualified to understand the financial terms and transaction
- Enough time have not been given to discover anything from the report
- Hold too many positions on different boards
- They get handsome remuneration from the promoter so they may oversees the real
  picture
- For a large corporate independent directors may not be the primary or sufficient
  tool for insuring good governance
- Legal standards may not be sufficient and powerful to prosecute the unethical
  governance practices

1.12.6 Attributes:
Though we may not have clearly attributed picture of a independent directors, from the
experience and suggestion from the corporate experts, government ministry initiatives,
apex bodies of the industry. The following attributes are expected in an independent
directors.
• Willingness to devote time in responsible manner to create the value for stakeholders.
• Commitment and dedication to the county and society as whole.
• They must be continue to act like independent directors of independent mind/decisions not like a de-facto employee of the company i.e. culprit in hands of promoter.
• Their role should not be limited to prevention, detection and reporting of the frauds/wrong doing but also need do add value for the stake holders.
• Must have ability to ask the hard questions and challenge the decisions of promoters when needed.
• Ability to listen patiently, contribute valuable inputs, awareness of the industry and available when needed.
• Creating protecting and sustaining the company’s strategic vision.
• They should be constructive challengers. Instead of merely detecting the error and mistakes he must suggest appropriate solutions for the problems.
• Ensure the right balance among the Individual, Social, Economic and environmental interests.

1.12.7 Challenges:
Value creation involves vision, risk taking and complex tradeoffs among a variety of different participants in the business enterprises of the firm. In order to maximize value, one should not only satisfy with the company values but ensure the support of all corporate stakeholders. The independent directors can play a crucial role in function it through its vision and strategic leadership. A board may face following challenges while deciding the codes for the independent directors:
• Who will appoint the independent directors & what procedure needs to follow?
• How to ensure coordination between independent directors?
• Tenure of independent directors.
• Whether independent directors be paid remuneration.
• Can any low prescribe attributes of an Independent director?
• What is to be paid to whom (especially executive directors) and who is appointed to senior positions on what basis?
Governance practices are beyond the realm of law.

Difficult to have clearly articulated law because of wide spectrum of industry (Large, Small, Global companies).

Independent directors may be independent according the laws and the listing agreements but may not be independent in terms of thoughts and actions.

Too much pressure on them can shrink the pull of ID for a board.

Person of integrity will not sacrifice their pride, dignities and reputation for the focus to being on some board i.e. that is not the attraction for them to become independent director.

Existing provisions are outdated government has to come out with higher standards of corporate governance and need to prosecute the wrong doer i.e. people with the set of greed, do not follow the ethics/governance practices and misuse the money of investors. India need a powerful process to prosecute and punish them as it was happened with Rajat Gupta in US. We also have the Stayam case for financial fraud but it is still pending for the final judgment. Establishment of higher standards needs the collaborations, participations and helping supports from the corporate and government. Ministry of corporate affairs has to work and participate with listed public limited companies to develop a successful model of corporate governance where businesses are based on the societal needs and professional to be of less greedy. Business needs to live in harmony with society and environment and create win-win situations for their stake holders.

Government can only provide an environment where good governance practices can take place. We also need to ensure that the investors should become the activist. In the various corporate governance activities the government has to ensure open and transparent reporting of self-compliance governance practices instead of becoming mere watch dog for the same. The effectiveness of the board requires appropriate compositions of board members in terms of demographics, skills, expertise, experience and value system etc. Diversity in board safeguards against single minded group think. Independent directors should meet without promoter/management once in a year. They should not depend on the promoter on any reference. An Indian institution has to come in raw and make world class institutions that should provide the source of qualified moral scholar to the corporate.
References:


Web Links:

   Inc performance below par on corporate governance
d. http://www.livemint.com/Companies/N5snOT772RI0dtTS8QlFNN/Sebi-board-approves-new-corporate-governance-norms-for-liste.html (SEBI Overhauls corporate governance norms for listed companies)
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