Chapter-III

STRUCTURE AND MECHANISM OF CORPORATE GOVERNANCE IN INDIA
The present chapter intends to provide a brief sketch on the structure and mechanisms of corporate governance in India. Before discussing the state of the corporate governance in India and its economy, it is important to provide some basic details. India is a large country with considerable heterogeneity in its population and economic base. India has more than 20 official languages spoken by over (Yasheng Huang & Tarun Khanna,) 1 Billion people spread throughout roughly 28 states with significant rural and urban populations. As the geographic and climatic conditions are varying greatly throughout India, there exists wide range of goods and services in the global market milieu.

The theme of corporate governance is to make sure the accountability of certain individuals in an organization through mechanisms that try to reduce or eliminate the principal-agent problem. The corporate governance is a multi-faceted subject. A related but separate thread of discussions focuses on the impact of a corporate governance system in economic efficiency, with a strong emphasis on shareholders' welfare. There are yet other aspects to the corporate governance subject, such as the stakeholder view and the corporate governance models around the world. In India, the question of corporate governance has come up mainly in the wake of economic liberalization, deregulation of industry and business, the demand for a new corporate ethos and stricter compliance with the law of the land. In the context of the unique situation in India where the financial institutions hold substantial stakes in companies, the accountability of the directors, including nonexecutive directors and nominees, has come into sharp focus. (Paradigm charted secretary 1997).

In India, a strident demand for evolving a code of good practices by the corporates themselves is emerging. In the global perspective, it may constitute a necessity to cut through the maze of prevalent questionable practices, indefensible management attitudes to stakeholders and penetrable non-disclosures. The initiatives taken by the Government in 1991, aimed at economic liberalization and globalization of the domestic economy, led India to initiate reform process in order to suitably respond to the developments taking place the world over. On account of the interest generated by Cadbury Committee Report, the Confederation of Indian Industry (CII), the Associated Chambers of Commerce and Industry (ASSOCHAM)
and, the Securities and Exchange Board of India (SEBI) constituted Committees to recommend framework for good Corporate Governance. (National Corporate Governance Policy, 2012). An examination of practices of accounting standards, and their issues in Indian industry may help to understand the existing practices of accounting standards, which in turn help in designing the effective standard practices so as to ensure good Corporate Governance. In this context, an attempt is made here to examine the accounting standards and their practices in India, with a view to strengthen the accounting standards and improve their practices for good Corporate Governance. (K. Shankaraiah, D.N. Rao)

There have been several major corporate governance initiatives launched in India since the mid-1990s. The first was by the Confederation of Indian Industry (CII), India's largest industry and business association, which came up with the first voluntary code of corporate governance in 1998. The second was by the SEBI, now enshrined as Clause 49 of the listing agreement. The third was the Naresh Chandra Committee, which submitted its report in 2002. The fourth was again by SEBI — the Narayana Murthy Committee, which also submitted its report in 2002. Based on some of the recommendations of this committee, SEBI revised Clause 49 of the listing agreement in August 2003. Subsequently, SEBI withdrew the revised Clause 49 in December 2003, and currently, the original Clause 49 is in force. But the corporate governance reforms in India are at a crossroads now; while corporate governance codes have been drafted with a deep understanding of the governance standards around the world, there is still a need to focus on developing more appropriate solutions that would evolve from within and, therefore, address the India-specific challenges more efficiently. (Santosh Pande, Kshama V Kaushik)

Pre-liberalization

During the initial years Indian organizations were bound by colonial rules and most of the rules and regulations catered to the whims and fancies of the British Employers. The companies act was introduced in the year 1866 and was gradually revised in 1882, 1913 and 1932. Indian Partnership act was introduced for the first time in 1932. The various agendas which were on its focus were managing agency model to corporate affair as individuals / business firms entered into legal contract
with joint stock companies. It was characterized by abuse / misuse of responsibilities by managing agent due to dispersed ownership. The issues of profit generation and control were dilapidated leading to various conflicts. (Aparna Sharma 2012).

The period of 1950s and 1960s was a period of setting up of industrial activities and cost plus regime. The genesis was the demand for very many products for which the Government administered Fair Prices. This was the time when the Tariff Commission and the Bureau of Industrial Costs and Prices were set up by the Govt. 1951 – India's development Regulation Act 1956 – Companies Act came into existence. Development and Banking institutions came into existence. The period between 70's to mid eighties was an era of Cost, Volume and Profit analysis, as an integral part of the Cost Accounting function. The history of the development of Indian corporate laws has been marked by interesting contrasts. (Goswami, 2002) At the time of independence, India inherited one of the world's poorest economies but one which had a factory sector accounting for a tenth of the national product; four functioning stock markets (predating the Tokyo Stock Exchange) with clearly defined rules governing listing, trading and settlements; a well-developed equity culture if only among the urban rich; and a banking system replete with well-developed lending norms and recovery procedures. In terms of corporate laws and financial system, therefore, India emerged far better endowed than most other colonies. The 1956 Companies Act as well as other laws governing the functioning of joint-stock companies and protecting the investors' rights were built on this foundation.

The beginning of corporate developments in India was marked by the managing agency system that contributed to the birth of dispersed equity ownership but also gave rise to the practice of management enjoying control rights disproportionately greater than their stock ownership. The turn towards socialism in the decades after independence marked by the 1951 Industries (Development and Regulation) Act as well as the 1956 Industrial Policy Resolution put in place a regime and culture of licensing, protection and widespread red-tape that bred corruption and stunted the growth of the corporate sector. The situation grew from bad to worse in the following decades and corruption, nepotism and inefficiency became the hallmarks of the Indian corporate sector. Exorbitant tax rates encouraged
creative accounting practices and complicated emolument structures to beat the
system. In the absence of a developed stock market, the three all-India development
finance institutions (DFIs) the Industrial Finance Corporation of India, the Industrial
Development Bank of India and the Industrial Credit and Investment Corporation of
India together with the state financial corporations became the main providers of
long-term credit to companies. Along with the government owned mutual fund, the
Unit Trust of India, they also held large blocks of shares in the companies they lent
to and invariably had representations in their boards. In this respect, the corporate
governance system resembled the bank-based German model where these
institutions could have played a big role in keeping their clients on the right track.

Unfortunately, they were themselves evaluated on the quantity rather than
quality of their lending and thus had little incentive for either proper credit appraisal
or effective follow-up and monitoring. Their nominee directors routinely served as
rubber-stamps of the management of the day. With their support, promoters of
businesses in India could actually enjoy managerial control with very little equity
investment of their own. Borrowers therefore routinely recouped their investment in
a short period and then had little incentive to either repay the loans or run the
business. Frequently they bled the company with impunity, siphoning off funds with
the DFI nominee directors mute spectators in their boards. This sordid but
increasingly familiar process usually continued till the company’s net worth was
completely eroded. This stage would come after the company has defaulted on its
loan obligations for a while, but this would be the stage where India’s bankruptcy
reorganization system, driven by the 1985 Sick Industrial Companies Act (SICA),
would consider it “sick” and refer it to the Board for Industrial and Financial
Reconstruction (BIFR).

As soon as a company is registered with the BIFR it wins immediate
protection from the creditors’ claims for at least four years. Between 1987 and 1992
BIFR took well over two years on an average to reach a decision, after which period
the delay has roughly doubled. Very few companies have emerged successfully from
the BIFR and even for those that needed to be liquidated, the legal process took over
10 years on average, by which time the assets of the company are practically
worthless. (Rajesh Chakrabarti, 2009). Protection of creditors’ rights has therefore
existed only on paper in India. Given this situation, it is hardly surprising that banks, flush with depositors' funds routinely decide to lend only to blue chip companies and park their funds in government securities. Financial disclosure norms in India have traditionally been superior to most Asian countries though they fell short of those in the USA and other advanced countries. Noncompliance with disclosure norms and even the failure of auditor's reports to conform to the law attract nominal fines with hardly any punitive action. The Institute of Chartered Accountants in India has not been known to take action against erring auditors. (Franklin Allen, Rajesh Chakrabarti, Sankar De, 2007)

While the Companies Act provides clear instructions for maintaining and updating share registers, in reality minority shareholders have often suffered from irregularities in share transfers and registrations – deliberate or unintentional. Sometimes non-voting preferential shares have been used by promoters to channel funds and deprive minority shareholders of their dues. Minority shareholders have sometimes been defrauded by the management undertaking clandestine side deals with the acquirers in the relatively scarce event of corporate takeovers and mergers. Boards of directors have been largely ineffective in India in monitoring the actions of management. They are routinely packed with friends and allies of the promoters and managers, in flagrant violation of the spirit of corporate law.

The nominee directors from the DFIs, who could and should have played a particularly important role, have usually been incompetent or unwilling to step up to the act. Consequently, the boards of directors have largely functioned as rubber stamps of the management. For most of the post-Independence era the Indian equity markets were not liquid or sophisticated enough to exert effective control over the companies. Listing requirements of exchanges enforced some transparency, but non-compliance was neither rare nor acted upon. All in all, therefore, minority shareholders and creditors in India remained effectively unprotected in spite of a plethora of laws in the books. (Sunanda Chavan, 2010).

Post - Liberalization

Since its financial liberalization began in 1991, India has undergone significant corporate governance reform. (Aggarwal, Reena, Leora Klapper, and
By the time of Independence in 1947, India had functioning stock markets, an active manufacturing sector, a fairly developed banking sector, and comparatively well developed, British-derived corporate governance. However, from 1947 through 1991, the Indian government pursued socialist policies. The state nationalized most banks, and became the principal provider of both debt and equity capital for non-state controlled firms. The government agencies who provided this capital were evaluated based on the amount of capital invested rather than return on investment. Competition, especially foreign competition, was suppressed. Private providers of debt and equity capital faced serious obstacles to exercising oversight over managers due to long delays in judicial proceedings and difficulty in enforcing claims in bankruptcy. Public equity offerings could be made only at government-set prices. Indian corporate governance deteriorated, and Indian firms looking for outside capital had to rely primarily on government sources. (Bhattacharyya & Rao, 2005; World Bank, 2005).

The Indian economy performed poorly. In 1991, the Indian government faced a fiscal crisis. It responded by enacting a series of reforms including reduction in state-provided financing, bank privatization, and general economic liberalization. The Securities and Exchange Board of India (SEBI) India's securities market regulator – was formed in 1992. By the mid-1990s, the Indian economy was growing steadily, and Indian firms began to seek equity capital to finance expansion into the market spaces created by liberalization and the growth of outsourcing. The need for capital, amongst other things, led to corporate governance reform. Talking to Frontline, E.A.S. Sarma pointed out that the weakening of regulatory mechanisms and the highly integrated nature of the financial markets provided opportunities for multi-dimensional scams. “And that is exactly what is happening. From insurance to banks to stock markets, frauds have moved on to areas like information technology. Land mafia, too, has become an integral part of these frauds.”

The present economic climate demands the initiation of new regulatory mechanisms. The introduction of audit by the Comptroller and Auditor General for all large corporations; making public information on all companies small or large, public or private, listed or unlisted; bringing back development financial institutions; reassessing the role of portfolio investors; and strengthening the policing of
politicians through genuine Lok Ayuktas. (FrontlineVolume26-Issue03: Jan 31-Feb 13, 2009 India's National Magazine from the publishers of The Hindu).

According to E.A.S. Sarma, former Secretary in the Ministry of Finance and an ardent campaigner for corporate accountability, 'the corporate frauds that have come to the fore since Independence can be broadly classified into three phases and categories: those perpetrated during a period when regulatory mechanisms were virtually non-existent; those that can be termed as 'regulatory capture' because they were advanced using the very regulatory norms that were supposed to ensure a strict and exacting regime; and those that came up in an unbridled manner in a climate of liberalisation. Chronologically, the first phase consisted of the decade and a half following Independence. The second phase extended to a period of nearly two and a half decades between the mid 1960s and the early 1990s. The third and current phase started in the early 1990s with economic liberalization.

The phrase corporate governance is relatively new in India. It gained prominence in the early 1990s as a number of scams took flare. Securities scam of 1992, disappearance of a number of companies after raising money through the stock market during the 1993-1994, etc. shattered investor's confidence, there were also cases of unscrupulous corporate issuing preferential equity allotments to their controlling group at steep discounts to the market price. All these episodes strengthened the case for corporate governance. Over the years, financial crises in the East Asian countries in 1997, corporate scandals in the USA in the beginning of this decade have tended to keep this issue in limelight and new guidelines have been developed. With the advent of Sarbanes & Oxley standards in USA, the need for disclosure of information has become paramount through such compliance. Comes with increased bureaucratization and hence higher costs as well.

These scandals were believed to have been made possible by the absence of well-defined regulatory mechanisms, and efforts were made to strengthen such mechanisms. According to observers of the financial sector, the 1960s was a period in which the government initiated several measures to put in place stringent regulatory mechanisms to control the sector. Among the notable initiatives of this period was the defining of norms for industrial licensing and allocation of bank credit. Further companies have realized that good corporate governance is a pre-
requisite for accessing funds from competitive capital markets in an increasingly integrated international economy leading to more transparent disclosures. (Arun Balakrishnan, C&MD, HPCL, 25th June, 2008). Currently, corporate governance reforms in India are at a crossroads; while corporate governance codes have been drafted with a deep understanding of the governance standards around the world, there is still a need to focus on developing more appropriate solutions that would evolve from within and, therefore, address the India-specific challenges more efficiently.

Reasons for Corporate Governance Failures,

If the Board is in awe of the family executive, it makes it difficult for the Board sometimes to ask tough questions or at other times the right questions at the right time in order to serve the interests of the shareholders better. As a result, truly independent directors are rarely found in Indian companies. (D. Murali,). Serving on multiple boards is problematic because doing so can overburden directors, thus hampering their performance, and increase the potential for directors to experience conflicts of interest between the various corporations they serve.( Bhat & Varun, 2007). It is admitted that contribution of the independent directors is limited because the average time spent in Board meetings by these directors is barely 14 to 16 hours in a year. In some cases, it has been found that no proper training and orientation regarding the awareness of rights, responsibilities, duties and liabilities of the directors is provided to an individual before appointing him/her as a director on the Board. (India PRwire Pvt. Ltd.2009) Also there is unseen but active participation of political class.

The directors on the board are largely reliant on information from the management and auditors, with their capacity to independently verify financial information being quite limited, while auditors, as this case suggests, have also been equally reliant on management information. The relevant issue here is the extent and the depth of auditors’ effort in their exercise of due diligence. Excessive reliance on information from the management is symptomatic of the ownership or control of companies in India by business families, and that poses a particular challenge for corporate governance in India. The greatest drawback of financial disclosures in
India is the absence of detailed reporting on related party transactions. In addition, poor quality of consolidated accounting and segment reporting leads to misrepresentation of the true picture of a business group.

Although India's investor-protection laws are sophisticated, litigants must wait a long time before receiving a judgment. Delays in the delivery of verdicts, high costs of litigation and the lengthy judicial appointment process in courts make the legal enforcement mechanism ineffective. According to the OECD, "the credibility and utility of a corporate governance framework rest on its enforceability." In India, the two audit-related issues which are commonly recognized are that of auditor independence (which is a problem worldwide) because of the large if segmented market in accounting services, and the perceived powerlessness of auditors in the face of corporate pressure. In many cases, they are ill-equipped to handle the needs of large companies, because in the face of an audit failure, it is very difficult to discern whether the auditors were complacent or whether they were pressurized by the concerted efforts of the insiders. There is no proper system to monitor the work of audit firms or to review the accounts prepared by the company's statutory auditors.

However, in the aftermath of the Satyam case, the SEBI has decided to introduce a peer review mechanism to review the accounts prepared by a company's statutory auditor. In addition, the SEBI has also decided to constitute a panel of auditors to review the financial statement of all BSE Sensex and NSE Nifty companies. Also there is no statutory compliance for the companies to obtain a report on Corporate Governance Rating by the Credit Rating Agencies in India. (D. Murali)

**Recommendations of various committees on Corporate Governance in India**

**CII Code recommendations (1997)**

CII took a special initiative on Corporate Governance, the first institutional initiative in Indian Industry, to develop and promote a code for Corporate Governance to be adopted and followed by Indian companies, whether in the private sector, the public sector, banks or financial institutions, all of which are corporate entities. The final draft of the said Code was widely circulated in 1997 and in April 1998, CII released, a Desirable Corporate Governance Code.
Board of directors

1. No need for German style two-tiered board

2. For a listed company with turnover exceeding Rs. 100 crores, if the Chairman is also the MD, at least half of the board should be Independent directors, else at least 30%.

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

4. Non-executive directors should be competent and active and have clearly defined responsibilities like in the Audit Committee.

5. Directors should be paid a commission not exceeding 1% (3%) of net profits for a company with (out) an MD over and above sitting fees. Stock options may be considered too.

6. Attendance record of directors should be made explicit at the time of re-appointment. Those with less than 50% attendance should not be reappointed.

7. Key information that must be presented to the board is listed in the code.

8. Audit Committee: Listed companies with turnover over Rs. 100 crores or paid-up capital of Rs. 20 crores should have an audit committee of at least three members, all non-executive, competent and willing to work more than other non-executive directors, with clear terms of reference and access to all financial information in the company and should periodically interact with statutory auditors and internal auditors and assist the board in corporate accounting and reporting.

9. Reduction in number of nominee directors. FIs should withdraw nominee directors from companies with individual FI shareholding below 5% or total FI holding below 10%.

Disclosure and Transparency

1. Companies should inform their shareholders about the high and low monthly averages of their share prices and about share, performance and prospects of major business segments (exceeding 10% of turnover).

2. Consolidation of group accounts should be a) Companies should inform their shareholders about the high and low monthly averages of their share prices and about share, performance and prospects of major business segments (exceeding 10% of turnover).
9. Consolidation of group accounts should be optional and subject to FI’s and IT department’s assessment norms. If a company consolidates, no need to annex subsidiary accounts but the definition of “group” should include parent and subsidiaries.

9. Stock exchanges should require compliance certificate from CEOs and CFOs on company accounts.

9. For companies with paid-up capital exceeding Rs. 20 crore, disclosure norms for domestic issues should be same as those for GDR issues.

Creditors’ Rights

5. FIs should rewrite loan covenants eliminating nominee directors except in the case of serious and systematic debt default or provision of insufficient information.

5. In the case of multiple credit ratings, they should all be reported in a format showing relative position of the company.

5. Same disclosure norms for foreign and domestic creditors.

5. Companies defaulting on fixed deposits should not be permitted to accept further deposits and make inter-corporate loans or investments or declare dividends until the default is made good.

Kumar Mangalam Birla Committee (SEBI) recommendations (2000)

While the CII code was well-received and some progressive companies adopted it, it was felt that under Indian conditions a statutory rather than a voluntary code would be more purposeful, and meaningful. Consequently, the second major corporate governance initiative in the country was undertaken by SEBI. In early 1999, it set up a committee under Kumar Mangalam Birla to promote and raise the standards of good corporate governance. In early 2000, the SEBI board had accepted and ratified key recommendations of this committee, and these were incorporated into Clause 49 of the Listing Agreement of the Stock Exchanges. This report pointed out that the issue of corporate governance involves besides shareholders, all other stakeholders. The committee’s recommendations have looked at corporate governance from the point of view of the stakeholders and, in particular, that of shareholders and investors.
The control and reporting functions of boards, the roles of the various committees of the board, the role of management, all assume special significance when viewed from this perspective. At the heart of committee’s report is the set of recommendations, which distinguish the responsibilities, and obligations of the boards and the management in instituting the systems for good Corporate Governance. Many of them are mandatory. These recommendations are expected to be enforced on listed companies for initial disclosures. This enables shareholders to know, where the companies are in which they have involved. The committee recognized that India had in place a basic system of corporate governance and that SEBI has already taken a number of initiatives towards raising the existing standards.

The committee also recognized that the Confederation of Indian Industries (CII) had published a code entitled “Desirable code of corporate of Governance and was encouraged to note that some of the forward looking companies have already reviewed their annual report through complied with the code. Now to protect investors, especially shareholders, from any malpractices and injustice, the Securities and Exchange Board of India appointed committee on corporate governance on May 7, 1999 under the chairmanship of Shri Kumar Managalam Birla, Member of SEBI Board, to promote standard of Corporate Governance.

**Board of Directors**

1. At least 50% non-executive members

2. For a company with an executive Chairman, at least half of the board should be independent directors, else at least one-third.

3. Non-executive Chairman should have an office and be paid for job related expenses.

4. Maximum of 10 directorships and 5 chairmanships per person.

5. **Audit Committee**: A board must have a qualified and independent audit committee, of minimum of 3 members, all non-executive, majority and chair independent with at least one having financial and accounting knowledge. Its chairman should attend AGM to answer shareholder queries. The committee
should confer with key executives as and when necessary and the company secretary should be the secretary of the committee. The committee should meet at least thrice a year - one before finalization of annual accounts and one necessarily every six months with the quorum being the higher of two members or one-third of members with at least two independent directors. It should have access to information from any employee and can investigate any legal/professional service as well as secure attendance of outside experts in meetings. It should act as the bridge between the board, statutory auditors and internal auditors with far-ranging powers and responsibilities.

6. Remuneration Committee: The remuneration committee should decide remuneration packages for executive directors. It should have at least 3 directors, all nonexecutive and be chaired by an independent director.

7. The board should decide on the remuneration of non-executive directors and all remuneration information should be disclosed in the annual report.

8. At least 4 board meetings a year with a maximum gap of 4 months between any 2 meetings. Minimum information available to boards stipulated.

Disclosure and Transparency

1. Companies should provide consolidated accounts for subsidiaries where they have majority shareholding.

2. Disclosure list pertaining to “related party” transactions provided by committee till ICAI’s norm is established.

3. A mandatory Management Discussion & Analysis segment of annual report that includes discussion of industry structure and development, opportunities, threats, outlook, risks etc. as well as financial and operational performance and managerial developments in HR/IR front.

4. Management should inform board of all potential conflict of interest situations.

5. On (re)appointment of directors, shareholders must be informed of their resume, expertise, and names of companies where they are directors.
Shareholders' Rights

5. Quarterly results, presentation to analysts etc. should be communicated to investors, possibly over the Internet.

5. Half-yearly financial results and significant events reports should be mailed to shareholders.

5. A board committee headed by a non-executive director should look into shareholder complaints/grievances.

5. Company should delegate share transfer power to an officer/committee/registrar/share transfer agents. The delegated authority should attend to share transfer formalities at least once in a fortnight.

The Committee in its report observed that "the strong Corporate Governance is indispensable to resilient and vibrant capital markets and is an important instrument of investor protection. It is the blood that fills the veins of transparent corporate disclosure and high quality accounting practices. It is the muscle that moves a viable and accessible financial reporting structure."

Naresh Chandra Committee Report

The Naresh Chandra committee was appointed in August 2002 by the Department of Company Affairs (DCA) under the Ministry of Finance and Company Affairs to examine various corporate governance issues. The Committee submitted its report in December 2002. It made recommendations in two key aspects of corporate governance: financial and non-financial disclosures; and independent auditing and board oversight of management. The committee submitted its report on various aspects concerning corporate governance such as role, remuneration, and training etc. of independent directors, audit committee, the auditors and then relationship with the company and how their roles can be regulated. The committee strongly believes that "a good accounting system is a strong indication of the management commitment to governance.

Good accounting means that it should ensure optimum disclosure and transparency, should be reliable and credible and should have comparability.
According to the committee, the statutory auditor in a company is the "lead actor" in disclosure front and this has been amply recognized in sections 209 to 223 of the companies act. The chief aspects concerning the auditors functioning as per the act are:

➢ Auditors are fiduciaries of the shareholders not of the management as they are appointed as the shareholders appoint them.

➢ Auditor's independence is guaranteed as rules for removing or replacing an auditor are more stringent than for reappointment.

➢ The statutory auditor of a company can, at all times, have the right of access to all books of accounts and vouchers of a company and his repeat can be quite exhaustive to specify whether, The auditor could obtain from management all information and explanations that were necessary for the purpose of audit.

➢ Proper books of accounts have been kept by the company

➢ Brained offices have been audited by him

➢ Company's accounts conform to accounting standards set by the institute of chartered Accountants of India. Some Mandatory functions are,

➢ The adequacy of internal control commensurate with the size of the company and its business.

➢ The adequacy of records maintained on fixed assets and inventories and whether any fixed assets were re-valued during the year.

➢ Loans and advances that were given by the company, and whether the parties concerned were regular in repaying the principal and interest.

➢ Loans and advances taken by the company and whether these were at terms in judicial to the interest of the company and also whether these were being property repaid according to conducted schedules.

➢ Transactions including loans and advances, with related parties as defined by section 301 of the companies act.
➢ Fixed deposits accepted by the company from the public and if so, whether these conform to the provisions laid down by section 58A of Co.’s Act.

➢ Regularity of depositing of provident fund dues and whether the employees’ State Insurance Act 1948, was applicable to the company.

➢ No personal expenses of directors and employees were charged to the profit & loss Act.

Guidelines of Committee to Auditors

i. For the public to have confidence in the quality of audit, it is essential that auditors should always be and be seen to be independent of the company, which includes integrity, professional ethics and objectivity.

ii. Before taking any work auditor must consider that there should not be any threat to his independence. And if it present he should adopt risk aversion virtue.

iii. Where such threats exist the auditor should either desist from the task or, at the very least, but in place safeguards that criminate them to reduce the threats to clearly insignificant levels. For the auditor is unable to fully implement credible and adequate safeguards then he must not do the work.

Narayana Murthy committee (SEBI) recommendations (2003)

In the year 2002, SEBI analyzed the statistics of compliance with the clause 49 by listed companies and felt that there was a need to look beyond the mere systems and procedures if corporate governance was to be made effective in protecting the interest of investors. SEBI therefore constituted a Committee under the Chairmanship of Shri N.R. Narayana Murthy, for reviewing the implementation of the corporate governance code by listed companies and issued revised clause 49 based on its recommendations.

Board of Directors

1. Training of board members suggested.

2. There shall be no nominee directors. All directors to be elected by shareholders with same responsibilities and accountabilities.
3. Non-executive director compensation to be fixed by board and ratified by shareholders and reported. Stock options should be vested at least a year after their retirement. Independent directors should be treated the same way as non-executive directors.

4. The board should be informed every quarter of business risk and risk management strategies.

5. **Audit Committee**: Should comprise entirely of “financially literate” non-executive members with at least one member having accounting or related financial management expertise. It should review a mandatory list of documents including information relating to subsidiary companies. “Whistle blowers” should have direct access to it and all employees be informed of such policy (and this should be affirmed annually by management). All “related party” transactions must be approved by audit committee. The committee should be responsible for the appointment, of the auditor.

6. Boards of subsidiaries should follow similar composition rules as that of parent and should have at least one independent directors of the parent company.

7. The Board report of a parent company should have access to minutes of board meeting in subsidiaries and should affirm reviewing its affairs.

8. Performance evaluation of non-executive directors by all his fellow Board members should inform a re-appointment decision.

9. While independent and non-executive directors should enjoy some protection from civil and criminal litigation, they may be held responsible for the legal compliance in the company’s affairs.

10. Code of conduct for Board members and senior management and annual affirmation of compliance to it.

**Disclosure and Transparency**

1. Management should explain and justify any deviation from accounting standards in financial statements.

2. Companies should move towards a regime of unqualified financial statements.
3. Management should provide a clear description, followed by auditor's comments, of each material contingent liability and its risks.

10. CEO/CFO certification of knowledge, veracity and comprehensiveness of financial statements and directors' reports and affirmation of maintaining proper internal control as well as appropriate disclosure to auditors and audit committee.

10. Security analysts must disclose the relationship of their employers with the client company as well as their actual or intended shareholding in the client company.

Narayana Murthy committee to review the performance of Corporate Governance and to determine the role of companies in responding to rumour and other price sensitive information circulating in the market in order to enhance the transparency and integrity of the market. The Committee in its Report observed that "the effectiveness of a system of Corporate Governance cannot be legislated by law, nor can any system of Corporate Governance be static. In a dynamic environment, system of Corporate Governance needs to be continually evolved." Based on the recommendations of the Committee, the SEBI had specified principles of Corporate Governance and introduced a new clause 49 in the Listing agreement of the Stock Exchanges in the year 2000. These principles of Corporate Governance were made applicable in a phased manner and all the listed companies with the paid up capital of Rs 3 crores and above or net worth of Rs 25 crores or more at any time in the history of the company, were covered as of March 31, 2003.

With a view to promote and raise the standards of Corporate Governance, SEBI on the basis of recommendations of the Committee and public comments received on the report and in exercise of powers conferred by Section 11(1) of the Securities and Exchange Board of India Act, 1992 read with section 10 of the Securities Contracts (Regulation) Act 1956, revised the existing clause 49 of the Listing agreement vide its circular SEBI/MRD/SE/31/2003/26/08 dated August 26, 2003. It clarified that some of the sub-clauses of the revised clause 49 shall be suitably modified or new clauses shall be added following the amendments to the Companies Act 1956 by the Companies (Amendment) Bill/Act 2003, so that the relevant provisions of the clauses on Corporate Governance in the Listing Agreement and the Companies Act remain harmonious with one another.
### Table 3.1: Summary of Clause 49

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<th>Characteristic</th>
<th>Clause 49</th>
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<tr>
<td><strong>Director Independence</strong></td>
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<tr>
<td><strong>Requirement</strong></td>
<td>50% independent directors if Chairman is executive director or 33% if Chairman is a non-executive.</td>
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<tr>
<td><strong>Definition</strong></td>
<td>no material pecuniary relationship with company, not related to Board or one level below Board and no prior relationship with the Company for the last 3 years.</td>
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<tr>
<td><strong>Nominee Directors of Financial Institutions</strong></td>
<td>considered independent.</td>
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<tr>
<td><strong>Board Requirements &amp; Limitations</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Meet 4 times a year (maximum 3 months between meetings)</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Limits on number of committees a director can be on (10)</strong></td>
<td>but only 5 for which director can be Chairman of committee.</td>
</tr>
<tr>
<td><strong>Code of Conduct (Ethics) required.</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Audit Committee Composition</strong></td>
<td></td>
</tr>
<tr>
<td><strong>At least 3 directors (two-thirds must be independent).</strong></td>
<td></td>
</tr>
<tr>
<td><strong>All financially literate.</strong></td>
<td></td>
</tr>
<tr>
<td><strong>At least one having accounting or financial management experience.</strong></td>
<td></td>
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<tr>
<td><strong>Audit Committee Role &amp; Powers</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Minimum 4 meetings/year (gap between meetings not to exceed 4 months).</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Broad role – review statutory and internal auditors as well as internal audit function, obtain outside legal or other professional advice, and review whistleblower program if one exists amongst other things.</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Disclosures</strong></td>
<td></td>
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<tr>
<td><strong>Related party transactions,</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Accounting treatments and departures,</strong></td>
<td></td>
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<tr>
<td><strong>Risk management,</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Annual report should include discussion of internal controls adequacy, significant trends, risks, and opportunities,</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Proceeds from offerings,</strong></td>
<td></td>
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</tbody>
</table>
In the Indian context, once clause 49 came into effect in 2005 end, the regulatory content for corporate governance changed significantly. Additionally, with much greater inflow of foreign institutional investments (FII) into the Indian capital markets, there has been an increasing demand for transparency and disclosure from Indian firms to be in line with the best practices in the developed world.

<table>
<thead>
<tr>
<th>Characteristic</th>
<th>Clause 49</th>
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<tbody>
<tr>
<td></td>
<td>▶ Compensation for directors (including non-executives and obtain shareholders’ approval),</td>
</tr>
<tr>
<td></td>
<td>▶ Details of compliance history for the last 3 years.</td>
</tr>
<tr>
<td></td>
<td>▶ Corporate governance reports (and discloses adoption, if any, of mandatory and non-mandatory requirements).</td>
</tr>
<tr>
<td>certifications</td>
<td>▶ CEO &amp; CFO:</td>
</tr>
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<td></td>
<td>▶ financial statements</td>
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<tr>
<td></td>
<td>▶ effectiveness of internal controls</td>
</tr>
<tr>
<td></td>
<td>▶ Inform audit committee of any significant changes in the above.</td>
</tr>
<tr>
<td></td>
<td>▶ Auditor or Company Secretary:</td>
</tr>
<tr>
<td></td>
<td>▶ Compliance with corporate governance</td>
</tr>
<tr>
<td>subsidiary companies</td>
<td>▶ At least one Independent director of Holding Company should sit as a director on Board of material non-listed Indian subsidiary.</td>
</tr>
<tr>
<td></td>
<td>▶ Significant transactions report to Holding Company Board (along with subsidiary board’s minutes).</td>
</tr>
<tr>
<td>other</td>
<td>Recommendations:</td>
</tr>
<tr>
<td></td>
<td>▶ Whistleblower policy is optional</td>
</tr>
<tr>
<td></td>
<td>▶ Independent director loses status as “independent” if served for 9 years at company</td>
</tr>
<tr>
<td></td>
<td>▶ Training board members</td>
</tr>
<tr>
<td></td>
<td>▶ Evaluate non executive board performance.</td>
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</tbody>
</table>
In 2004, the Government constituted a committee under the Chairmanship of Dr. J.J. Irani, Director, Tata Sons, with the task of advising the Government on the proposed revisions to the Companies Act, 1956 with the objective to have a simplified compact law that would be able to address the changes taking place in the national and international scenario, enable adoption of internationally accepted best practices as well as provide adequate flexibility for timely evolution of new arrangements in response to the requirements of ever-changing business models. This committee recommended the formation of Limited Liability Partnership (LLP) and One Person Company in India.

The new guidelines on corporate governance issued at the year of 2007 for the state owned enterprises in India are quite similar to the clause 49 requirements. These include guidelines with respect to role of the board of directors and management, audit committee, code of conduct and business ethics etc. These guidelines are voluntary. However, the department of public enterprises may grade state owned enterprises on the basis of the compliance with the guidelines. While there is no denying that these guidelines promote the objective of good corporate governance, however, certain challenges remain. (Arun Balakrishnan, C & MD, HPCL). There is no denying the fact that clause 49 and the new guidelines provide an ideal setting for corporate governance. This is essential as the Indian economy and companies operate in an integrated international economy. However, as is the case with any statute, it is quite often implementation which determines the effectiveness.

Corporate Governance voluntary guidelines 2009

More recently, in December 2009, the Ministry of Corporate Affairs (MCA) published a new set of “Corporate Governance Voluntary Guidelines 2009”, designed to encourage companies to adopt better practices in the running of boards and board committees, the appointment and rotation of external auditors, and creating a whistle blowing mechanism. These Guidelines were drawn from the report of the Task Force of CII on Corporate Governance headed by Shri Naresh Chandra and the recommendations of the Institute of Company Secretaries of India.
for Strengthening Corporate Governance Framework. These guidelines sought to provide corporate India a framework to govern themselves voluntarily as per the defined standards of ethics and responsible conduct of business code by listed companies and issued revised clause 49 based on its recommendations.

The guidelines are divided into the following six parts:

- Board of Directors
- Responsibilities of the Board
- Audit Committee of the Board
- Auditors
- Secretarial Audit
- Institution of mechanism for Whistle Blowing

These guidelines provide for a set of good practices which may be voluntarily adopted by the Public companies. Private companies, particularly the bigger ones, may also like to adopt these guidelines. The guidelines are not intended to be a substitute for or additions to the existing laws but are recommendatory in nature.

Despite these wide-ranging developments in regulation and policy, what becomes increasingly apparent in India is that the reform process has not addressed, or effectively addressed, a key challenge at the heart of the governance problem, namely the accountability of promoters to other shareholders. Even though most listed companies have large controlling shareholders, typically a family, the regulation of related-party transactions in India is minimal. Promoters have considerable freedom of action in undertaking such transactions and are subject to only limited regulatory controls. They are also permitted to issue preferential warrants to themselves at an effective discount to the market price—something that would not be condoned in more developed markets.

In this context, relying largely on independent directors (appointed by controlling shareholders), independent board committees and greater corporate disclosure as the primary mechanisms to check abuses of power by promoters and to
safeguard the interests of minority shareholders is likely to prove weak and insufficient (as indeed it did in the Satyam case). Board reform is fundamentally important, and is a major issue of concern to institutional investors, but it needs to be complemented by other regulations that directly address the relationship between controlling and minority shareholders in other words, a proper regime for the regulation of related-party transactions.

While some leading Indian companies deserve credit for actively pursuing high standards of governance, including producing examples of world-class corporate disclosure, the strong growth of the economy and capital markets has fostered, in our view, a fair degree of complacency towards corporate governance and the rights of minority shareholders. As this paper shows, few listed companies in India are attuned to a major global trend of the past five years the expansion of cross-border proxy voting nor do they seem interested in voluntarily enhancing the transparency and fairness of their annual general meetings (e.g., by fully counting all votes through a "poll", rather than conducting voting by the old system of a show of hands). This complacency is also reflected in the ongoing difficulties that investors face in deciphering the financial statements of some listed companies, including even some large caps.

Guidelines on Corporate Governance for Central Public Sector Enterprises 2010

The Department of Public Enterprises (DPE) which is the nodal Department for laying down policies and guidelines concerning Central Public Sector Enterprises (CPSEs) has issued the Guidelines on Corporate Governance for Central Public Sector Enterprises 2010. These guidelines are applicable to both listed as well as unlisted public sector enterprises.

Companies Bill, 2011 and its Impact on Corporate Governance in India

The foundations of the comprehensive revision in the Companies Act, 1956 were laid in 2004 when the Government constituted the Irani Committee 59 to conduct a comprehensive review of the Act. The Government of India has placed before the Parliament a new Companies Bill, 2011, that incorporates several
significant provisions for improving corporate governance in Indian companies. This Bill, having gone through an extensive consultation process, is expected to be approved in the 2012 Budget session. The new Companies Bill, 2011 proposes structural and fundamental changes in the way companies would be governed in India and incorporates various lessons that have been learnt from the corporate scams of the recent years that highlighted the role and importance of good governance in organizations. Significant corporate governance reforms, primarily aimed at improving the board oversight process, have been proposed in the new Companies Bill; for instance it has proposed, for the first time in Company Law, the concept of an Independent Director and all listed companies are required to appoint independent directors with at least one-third of the Board of such companies comprising independent directors.

The Companies Bill, 2011 takes the concept of board independence to another level altogether as it devotes two sections to deal with Independent Directors. The definition of an Independent Director has been considerably tightened and the definition now defines positive attributes of independence and also requires every Independent Director to declare that he or she meets the criteria of independence. In order to ensure that Independent Directors maintain their independence and do not become too familiar with the management and promoters, minimum tenure requirements have been prescribed. The initial term for an independent director is for five years, following which further appointment of the director would require a special resolution of the shareholders. However, the total tenure for an independent director is not allowed to exceed two consecutive terms. The new Companies Bill, 2011 expressly disallows Independent Directors from obtaining stock options in companies to protect their independence.

The new guidelines which set out the role, functions and duties of Independent Directors and their appointment, resignation and evaluation introduce greater clarity in their role; however, in certain places they are prescriptive in nature and could end up making the role of Independent Directors quite onerous. In order to balance the extensive nature of functions and obligations imposed on Independent Directors, the new Companies Bill, 2011 seeks to limit their liability to matters directly relatable to them and limits their liability to “only in respect of acts of
omission or commission by a company which had occurred with his knowledge, attributable through board processes, and 'with his consent or connivance or where he had not acted diligently". In the background of the current provisions in the Companies Act, 1956 which do not provide any clear limitation of liability and have left it to be interpreted by Courts, it is helpful to provide a limitation of liability clause.

The new Bill also requires that all resolutions in a meeting convened with a shorter notice should be ratified by at least one independent director which gives them an element of veto power. Various other clauses such as those on directors' responsibility statements, statement of social responsibilities, and the directors' responsibilities over financial controls, fraud, etc, will create a more transparent system through better disclosures. A major proposal in the new Bill is that any undue gain made by a director by abusing his position will be disgorged and returned to the company together with monetary fines. Other significant proposals that would lead to better corporate governance include closer regulation and monitoring of related-party transactions, consolidation of the accounts of all companies within the group, self-declaration of interests by directors along with disclosures of loans, investments and guarantees given for the businesses of subsidiary and associate companies.

A significant first, in the proposals under the new Companies Bill, is the provision that has been made for class action suits; it is provided that specified number of members may file an application before the Tribunal on behalf of members, if they feel that the management or control of the affairs of the company are being conducted in a manner prejudicial to the interests of the company or its members. The order passed by the Tribunal would be binding on the company and all its members. The enhanced investor protection framework, proposed in the Bill, also empowers small shareholders who can restrain management from actions that they believe are detrimental to their interests or provide an option of exiting the company when they do not concur with proposals of the majority shareholders.

The Companies Bill, 2011 seeks to provide clarity on the respective roles of SEBI and the MCA and demarcate their roles – while the issue and transfer of securities and non-payment of dividend by listed companies or those companies
which intend to get their securities listed shall be administered by the SEBI. All other cases are proposed to be administered by the Central Government. Furthermore, by focusing on issues such as Enhanced Accountability on the part of Companies, Additional Disclosure Norms, Audit Accountability, Protection for Minority Shareholders, Investor Protection, Serious Fraud Investigation Office (SFIO) in the new Companies Bill, 2011, the MCA is expected to be at the forefront of Corporate Governance reforms in India.

Need for Concept Paper on National Corporate Governance Policy, 2012

Concept Paper on National Policy on Corporate Governance seeks to align and synergize the corporate governance norms prescribed by various regulatory bodies, benchmark good governance practices for the corporate sector to apply, encourage corporates to adopt the best governance practices leading to sustained growth of corporates embracing therein inclusive growth of the economy as a whole.

Objectives of Corporate Governance Policy

The objectives of this policy are to provide guidance on inclusion of corporate governance practices to: Priority areas of reforms; inculcate a strong culture of core values, ethics, integrity, reliability and fair dealings amongst corporates to achieve a balance between providing protection to investors and fostering fair and efficient capital markets and confidence in capital markets; promote sustainable and inclusive growth of the corporate sector; and recognize that corporate governance is evolving in respect of:

➢ Adequate disclosures and effective decision making
➢ Transparency in business transactions;
➢ Commitment to values and ethical conduct of business

This Policy is an inclusive one and not intended to be prescriptive. The corporates are encouraged to consider this policy in developing their own corporate governance policy/codes.
Principles of Corporate Governance Policy

A. Board Composition

i. Size of the Board

The size of the Board should neither be too small nor too big. Experience indicates that smaller boards allow for real strategic discussion. At the same time, larger Boards provide the benefit of diverse experience and viewpoints. The board should strike a balance between executive and non-executive directors.

The board should ensure that there is an appropriate balance of power and authority on the board. No one individual or block of individuals should be able to dominate the board's decision-making.

ii. Board Membership Criteria

All directors should be individuals of integrity and courage, with relevant skills and experience to bring judgment to bear on the business of the company.

iii. Diversity in Board

Every board should consider whether its size, diversity and demographics make it effective. Diversity applies to academic qualifications, technical expertise, relevant industry knowledge, experience, nationality, age and sex. Diversity adds value, and adds to the bottom line. Gender diversity is an important aspect of board diversity and companies should have women representation on the Boards.

iv. Board renewal - tenure of independent directors

Boards need to be regularly refreshed with new expertise, energy and experience. Independent directors should not have long tenure. A balance should be sought between continuity in board membership, subject to performance and eligibility for re-election and the sourcing of new ideas through the introduction of new board members. Every Company should frame a Board Renewal Policy of Independent Directors to facilitate their independence. The Policy may provide for maximum number of years a person could serve on the Board as an Independent Director.
v. Separation of Office of Chairman and Chief Executive Officer

The role and office of the Chairman and CEO should be separated to promote balance of power and to prevent unfettered decision making power with a single individual. Further, there should be a clear demarcation of the role and responsibilities of Chairman and Managing Director/Chief Executive Officer (CEO).

B. Board Committees

Board committees with formally established terms of reference, criteria for appointment, life span, role and function constitute an important element of the governance process and should be established with clearly agreed reporting procedures and a written scope of authority. Committees are usually formed as a means of improving board effectiveness and efficiency in areas where more focused, specialized and technical discussions are required. These committees prepare the groundwork for decision-making and report at the subsequent board meeting. "Committees enable better management of full boards time and allow in-depth scrutiny and focused attention.

The Board of Directors is ultimately responsible for the acts of the committee and therefore should define the committees role and structure. The Board should consider constituting the following committees for better functioning:

1. Audit Committee 2. Shareholders/Investors Relations Committee 3. Remuneration Committee 4. Nomination Committee 5. Corporate Governance Committee 6. Risk Management Committee 7. CSR Committee In addition to the above committees, the board may constitute other committees, depending upon the organizations size and other requirements.

C. Number of Directorships

Effective Board room performance of Directors is directly related to the time that they can devote. A Director should not hold a number of directorship positions at the same time. The number of companies in which an individual may become a director should be restricted for all directors, specifically if the person is Managing Director or Whole time director in the company.
D. Training of Directors

The companies should ensure that directors are inducted through a suitable familiarization process covering, inter-alia, their roles, responsibilities and liabilities. Efforts should be made to ensure that every director has the ability to understand basic financial statements and information and related documents/papers. There should be a statement to this effect by the Board in the Annual Report. Besides this, the Board should also adopt suitable methods and training programmes to enrich the skills of directors from time to time. Board Evaluation The Board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.

The Board should state in the Annual Report how performance evaluation of the Board, its committees and its individual directors has been conducted. Lead Independent Director If the offices of Chairman of the Board and Chief Executive Officer are held by the same person, the Board should name a lead independent director to ensure a structure that provides an appropriate balance between the powers of the CEO and those of the independent directors. The Lead Independent Director serves as an important liaison between the Board and Independent Directors. Other roles of the lead independent director may include chairing meetings of non-executive directors and of independent directors, presiding over Board meetings in the absence of the chair, serving as the principal liaison between the independent directors and the chair, and leading the Board/director evaluation process. Given these additional responsibilities, the lead independent director should be expected to devote a greater amount of time to Board service than the other directors.

E. Transparency & Disclosures

The corporate governance framework of an organization should ensure that timely and accurate disclosures are made on all its material information, including the financial position, performance, ownership, and governance of the company. Disclosure should include, but not be limited to, material information on:
i. The financial and operating results of the company.

Company Profile

Corporate Governance Report

- Governance Structure and Policies
- Ownership and shareholder's rights including changes in control
- Detailed information about the Board
- Risk Management Framework
- Existence of Internal Code of Conduct, Business Ethics and Whistle Blower Mechanism
- Particulars of Internal Auditors
- Secretarial Audit
- Commitment to external initiatives

Sustainability Report

- Economic Performance
- Environmental Performance
- Social Performance
- Value Statements
- CSR Initiatives

Innovation Strategy / Research & Development

Intangible Assets Reporting

Information should be prepared and disclosed in accordance with the standards of accounting - financial and non-financial.

Annual audit should be conducted by independent, competent and qualified auditors in order to provide an external and objective assurance to the board and shareholders that the financial and non-financial statements fairly represent the financial position and Environment, Social and Governance (ESG) performance of the company in all material respects. H. Related Party Transactions (RPTs) A related
party transaction can present a potential or actual conflict of interest and may not be consistent with the best interests of the company and its shareholders. The related party transactions should be managed in a transparent and legal manner so that these do not impose a heavy burden on the financial resources of a company, distort competition, affect optimum allocation of resources, waste public resources and lead to corrupt practices.

F. Shareholders Rights

Equity investors have certain rights. An equity share entitles the investor to participate in the profits of the corporation, with liability limited to the amount of the investment. In addition, ownership of an equity share provides a right to information about the corporation and a right to influence the corporation, primarily by participation in general shareholder meetings and by voting. The shareholding body is made up of different types of shareholders like individuals and institutions and the responsibility for corporate strategy and operations is typically placed in the hands of the Board of Directors and its management team. Basic shareholder rights which should be provided by every organization include the right to: 1) Secure methods of ownership registration; 2) Transfer ownership of shares; 3) Obtain relevant and material information about the corporation on a timely and regular basis; 4) Participate and vote in general shareholder meetings; 5) Elect and remove members of the board; and 6) Share in the profits of the corporation.

Responsibilities of Institutional Shareholders:- holding additional meetings with management specifically to discuss the specific shareholders concerns; meeting with the Chairman, senior independent director, or with all independent directors; making a public statement in advance of the AGM or an EGM; and submitting resolutions at shareholders meetings.

G. Sustainability

The importance of businesses in improving the quality of life is well recognized. However, there is growing awareness that in an increasingly complex world, businesses also have significant and long-lasting impact on people, planet and ability to sustain the levels of holistic development that is aspired to. This
realization has also brought an increasing concern amongst all stakeholders, who are demanding that businesses of all types and sizes need to function with fairness and responsibility. Specifically, this calls for businesses being thoroughly aware and conscious of their social, environmental and economic responsibilities, and balance these different considerations in an ethical manner. A key challenge for Board, therefore, is mainstreaming the sustainability issues. The corporate Boards must integrate strategy, sustainability and control (integrated governance), and establish the values and ethics that underpin sustainable practices. It is, therefore, in the long-term interest of corporations to foster wealth-creating cooperation among stakeholders. The governance framework should recognize that the interest of the corporation is best served by serving the interests of all stakeholders and recognising their contribution to the long-term success of the corporation.

H. Ethics and Integrity

Good corporate governance is essentially about effective and responsible leadership, which calls for integrity, transparency and accountability. Leaders need to define strategy, provide direction and establish the ethics and values that will influence and guide practices and behaviour to achieve sustainable performance. Companies should develop governance structures, procedures, practices and codes that ensure ethical conduct at all levels.

J. The Responsibilities of the Board

The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the boards accountability to the company and the shareholders. Therefore, the Board members, jointly and severely, should assume following responsibilities: Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and all its stakeholders. Where board decisions may affect different shareholder groups differently, the board should treat all shareholders fairly. The board should apply high ethical standards. It should take into account the interests of all stakeholders. The board should fulfil certain key functions, including:
Reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans; setting performance objectives; monitoring implementation and corporate performance; and overseeing major capital expenditures, acquisitions and divestitures.

Monitoring the effectiveness of the companies governance practices and making changes as needed.

Selecting, compensating, monitoring and, when necessary, replacing key executives and overseeing succession planning.

Aligning key executive and board remuneration with the long term interests of the company and its shareholders.

Ensuring a formal and transparent board nomination and election process.

Monitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions.

Ensuring the integrity of the corporations accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for risk management, financial and operational control, and compliance with the law and relevant standards.

Overseeing the process of disclosure and communications. The board should be able to exercise objective independent judgement on corporate affairs.

The mandate, composition and working procedures of committees of the Board should be well defined and disclosed by the board. Board members should commit themselves effectively to their responsibilities. In order to fulfill their responsibilities, board members should have access to accurate, relevant and timely information.

Oversight of Implementation and Coordination between Regulatory Agencies

To achieve the objectives of this Policy, an institutional framework has been proposed to undertake, coordinate and oversee its implementation in cooperation with Central Ministries, sectoral regulators, enforcement agencies and other stakeholders.
Figure 3.1
FRAMEWORK OF CORPORATE GOVERNANCE

Corporate Governance Framework

Organizational Framework

Legal Framework

MCA

SEBI

CII Recommendations (1997-98)

Companies Act, 1956

Companies Bill, 2004

Section 292A (Setting up an Audit Committee)

Section 211 (Statutory Compliance of AS)

Kumar Manglam Birla Committee Report (2000-01) (Listing Agreement)

Clause 49

Naresh Chandra Committee Report on Corporate Audit and Governance 2002

NFCG (Association with CII, ICAI, ICSI)


Depositories Act, 1996

Securities Contracts (Regulation) Act, 1956

SEBI Act, 1992

Source: Mr. Bhavik M. Panchasara et al., (2012)

An Empirical Study on Corporate Governance in Indian Banking Sector
Regulatory Mechanisms of corporate governance

A natural question to ask, given the theory behind corporate governance, is why do we need to impose particular governance regulations through stock exchanges, legislatures, courts or supervisory authorities? If it is in the interest of firms to provide adequate protection to shareholders, why mandate rules, which may be counterproductive? Even with the best intentions regulators may not have all the information available to design efficient rules. Worse still, there is a danger that regulators can be captured by a given constituency and impose rules favoring one group over another. (Discussion Paper 2004)

In our country, there are some major mechanisms to ensure corporate governance:

Companies Act

Companies in our country are regulated by the companies Act, 1956, as amended up to date. The companies Act is one of the biggest legislations with 658 sections and 14 schedules. The arms of the Act are quite long and touch every aspect of a company's insistence. But to ensure corporate governance, the Act confers legal rights to shareholders to

5. Vote on every resolution placed before an annual general meeting;
5. To elect directors who are responsible for specifying objectives and laying down policies;
5. Determine remuneration of directors and the CEO;
5. Removal of directors and
5. Take active part in the annual general meetings.

Securities law

The primary securities law in our country is the SEBI Act. Since its setting up in 1992, the board has taken a number of initiatives towards investor protection. One such initiative is to mandate information disclosure both in prospectus and in annual accounts. While the companies Act itself mandates certain standards of information disclosure, SEBI Act has added substantially to these requirements in an
attempt to make these documents more meaningful. The main objective of SEBI regulation is shareholder value maximization by putting corporate governance structures in place and through the reduction of information asymmetry between the managers and the investors of the company. Jønsen (2000) also argues in favour of shareholder wealth maximization as the main objective function of any company.

Reserve Bank of India (RBI)

The RBI, established in 1935, is the central bank of India and is entrusted with monetary stability, currency management and supervision of the financial and payments systems. Its functions and focus have evolved in response to India’s changing economic environment. It acts as the banker to the state and national governments, the lender of last resort and the controller of the country’s money supply and foreign exchange. The RBI supervises the operations of all banks and NBFCs in the country. It is responsible for monetary policy, setting benchmark interest rates, managing the treasury operations (both borrowings and redemption) for the government and acts as custodian and controller of the foreign exchange reserves.

Discipline of the capital market

Capital market itself has considerable impact on corporate governance. Here in lies the role the minority shareholders can play effectively. They can refuse to subscribe to the capital of a company in the primary market and in the secondary market; they can sell their shares, thus depressing the share prices. A depressed share price makes the company an attractive takeover target.

Nominees on company boards

Development banks hold large blocks of shares in companies. These are equally big debt holders too. Being equity holders, these investors have their nominees in the boards of companies. These nominees can effectively block resolutions, which may be detrimental to their interests. Unfortunately, the role of nominee directors has been passive, as has been pointed out by several committees including the Bhagwati Committee on takeovers and the Omkar Goswami committee on corporate governance.
Statutory Audit

Statutory audit is yet another mechanism directed to ensure good corporate governance. Auditors are the conscience-keepers of shareholders, lenders and others who have financial stakes in companies.

Auditing enhances the credibility of financial reports prepared by any enterprise. The auditing process ensures that financial statements are accurate and complete, thereby enhancing their reliability and usefulness for making investment decisions.

Codes of Conduct

The mechanisms discussed till now are regulatory in approach. They are mandated by law and violations of any provision invite penal action. But legal rules alone cannot ensure good corporate governance. What is needed is self-regulation on the part of directors, besides of course, the mandatory provisions.

Global best practices

A number of supranational organisations have drawn codes/principles of corporate governance. The most well known is perhaps the OECD principles of corporate governance of 1999. It is instructive to summarise the five basic pillars of OECD code, viz.,

i. Protecting the rights of shareholders;

ii. Ensuring equitable treatment of all shareholders including having an effective grievance redressal system;

iii. Recognizing the rights of stakeholders as established by law;

iv. Ensuring the timely and accurate disclosure regarding the corporation including the financial situation, performance, ownership and governance of the company; and

v. Ensuring the strategic guidance of the company, effective monitoring arrangement by the board and the board’s responsibility to the company and the shareholder. While the OECD principles went a long way in emphasizing the basic tenets of corporate governance. (Shyamala Gopinath, 2004)
Systemic problems of corporate governance

➢ Demand for information: A barrier to shareholders using good information is the cost of processing it, especially to a small shareholder. The traditional answer to this problem is the efficient market hypothesis (in finance, the efficient market hypothesis (EMH) asserts that financial markets are efficient), which suggests that the shareholder will free ride on the judgements of larger professional investors.

➢ Monitoring costs: In order to influence the directors, the shareholders must combine with others to form a significant voting group which can pose a real threat of carrying resolutions or appointing directors at a general meeting.

➢ Supply of accounting information: Financial accounts form a crucial link in enabling providers of finance to monitor directors. Imperfections in the financial reporting process will cause imperfections in the effectiveness of corporate governance. This should, ideally, be corrected by the working of the external auditing process.

Above attempts made by the various regulating bodies show a rising level of concern for the manner in which the corporate manage themselves and their geopolitical environment. As more and more multi nationals chip in to utilize cheap Indian labors – the regulating bodies will not have the only onus of task building, but will also have to ensure means to implement the regulations. Not only this, as more and more stakeholders make an attempt to maximize their profits, the investors (especially the smaller) will have to be wary of the crafty speculators who can ruin the market confidence and decimate them. Investor training, therefore, is an important area of immediate action. Organizations cannot create long term value without having appropriate corporate governance policies in place, as the need of the hour is to not only manage earnings, but also to create value. It becomes of utmost importance especially for a country like India, as it comprises of the various odd sections of the society that are yet to realize the value of information to small investors. Moreover, with the change in the context there is also a need to evolve the governance policies suiting the geopolitical, social and economic environment of that state.
In the last few years the thinking on the topic in India has gradually crystallized into the development of norms for listed companies. The problem for private companies, that form a vast majority of Indian corporate entities, remains largely unaddressed. The agency problem is likely to be less marked there as ownership and control are generally not separated. Minority shareholder exploitation, however, can very well be an important issue in many cases.

Development of norms and guidelines are an important first step in a serious effort to improve corporate governance. The bigger challenge in India, however, lies in the proper implementation of those rules at the ground level. More and more, it appears that outside agencies like analysts and stock markets (particularly foreign markets for companies making GDR issues) have the most influence on the actions of managers in the leading companies of the country. But their influence is restricted to the few top (albeit largest) companies. More needs to be done to ensure adequate corporate governance in the average Indian company. Even the most prudent norms can be hoodwinked in a system plagued with widespread corruption. Nevertheless, with industry organizations and chambers of commerce themselves pushing for an improved corporate governance system, the future of corporate governance in India promises to be distinctly better than in the past.
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