Corporate Governance in India: A legal Analysis

Prabhash Dalei, Paridhi Tulsyan and Shikhar Maravi

Abstract—The present paper aims at reviewing the various developments in Corporate Governance in India. Corporate Governance has gained a lot of importance and momentum the world over. The objective of any corporate governance system is to simultaneously improve corporate performance and accountability as a means of attracting financial and human resources on the best possible terms and of preventing corporate failure. In short Corporate Governance is about promoting corporate fairness, transparency and accountability.

Keywords—Corporate Governance, Corporations, Stakeholders, Investors.

I. INTRODUCTION

Corporate Governance is essentially all about how corporations are directed, managed, controlled and held accountable to their shareholders. In India, the question of Corporate Governance has come up mainly in the wake of economic liberalization and de-regularization of industry and business. The objective of any corporate governance system is to simultaneously improve corporate performance and accountability as a means of attracting financial and human resources on the best possible terms and of preventing corporate failure. With the rapid pace of globalization many companies have been forced to tap international financial markets and consequently to face greater competition than before. Both policymakers and business managers have become increasingly aware of the importance of improved standards of Corporate Governance.

II. DEFINITION OF CORPORATE GOVERNANCE

Definition of Corporate Governance varies widely. Corporate Governance could be defined as ways of bringing the interests of investors and managers into line and ensuring that firms are run for the benefit of investors [1]. It is concerned with the relationship between the internal governance mechanisms of corporations and society’s conception of the scope of corporate accountability [2]. Corporate governance is 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 about commitment to values, about ethical business conduct and about making a distinction between personal and corporate funds in the management of a company. Corporate Governance consists of procedures and processes according to which an organisation is directed and controlled. The Corporate Governance structure specifies the distribution of rights and responsibilities among the different participants in the organisation such as the board, managers, shareholders and other stakeholders and lays down the rules and procedures for decision-making [3]. Corporate Governance is about promoting corporate fairness, transparency and accountability [4]. In simple terms Corporate Governance can be defined as a set of laws, rules, regulations, systems, principles, process by which a company is governed.

III. NEED FOR CORPORATE GOVERNANCE IN INDIA

A corporation is a congregation of various stakeholders, namely customers, employees, investors, vendor partners, government and society. In this changed scenario an Indian corporation, as also a corporation elsewhere, should be fair and transparent to its stakeholders in all its transactions. This has become imperative in today’s globalized business world where corporations need to access global pools of capital, need to attract and retain the best human capital from various parts of the world, need to partner with vendors on mega collaborations and need to live in harmony with the community. Unless a corporation embraces and demonstrates ethical conduct, it will not be able to succeed.

Corporations need to recognize that their growth requires the cooperation of all the stakeholders; and such cooperation is enhanced by the corporations adhering to the best Corporate Governance practices. In this regard, the management needs to act as trustees of the shareholders at large and prevent asymmetry of benefits between various sections of shareholders, especially between the owner-managers and the rest of the shareholders.

IV. EVOLUTION OF CORPORATE GOVERNANCE IN INDIA

Liberalization and its associated developments, i.e. deregulation, privatization and extensive financial liberalization, have made effective Corporate Governance very crucial. Cases of frauds, malpractices can render capital market reforms desultory. Independent and effective corporate governance reforms are, therefore, necessary in order to restore the credibility of capital market and to facilitate the flow of investment finance of firms. There are various reforms which were channelled through a number of different paths.
with both the Security and Exchange Board of India (SEBI) and the Ministry of Corporate Affairs, Government of India (MCA) playing important roles.

A. Committee on Corporate Governance

There are various committees formed with a view to reforming the Corporate Governance in India since 1990s. Some of the recommendations of these committees are highlighted below.

1. Confederation of Indian Industries (CII) set up a task force in 1995 under Rahul Bajaj, a reputed industrialist. In 1998, the CII released the code called “Desirable Corporate Governance”. It looked into various aspects of Corporate Governance and was first to criticize nominee directors and suggested dilution of government stake in companies.

2. SEBI had set up a Commission under Kumarmanlagam Birla. This committee covered issues relating to protection of investor interest, promotion of transparency, building international standards in terms of disclosure of information.

3. The Department of Companies Affairs (DCA) modified the Companies Act, 1956. It undertakes periodic review and brings about amendments in the Companies Act, 1956. In 1999, the Act introduced the provision relating to nomination facilities for shareholders and share buybacks and for formation of Investor education and protection fund.

4. The Department of Corporate Affairs constituted Naresh Chandra Committee in 2002. The committee talks extensively about the statutory auditor-company relationship, rotation of statutory audit firms/partners, procedure for appointment of auditors and determination of audit fees, true and fair statement of financial affairs of companies.

5. SEBI appointed Narayan Murthy Committee in 2002. Its report mainly focuses on and makes mandatory recommendations regarding responsibilities of audit committee, quality of financial disclosure, requiring boards to assess and disclose business risks in the company’s annual reports.

B. Clause 49 of the Listing Agreement

After liberalization serious efforts have been made towards overhauling the system with SEBI formulating the Clause 49 of the Listing Agreements dealing with corporate governance. Clause 49 of the Listing Agreement to the Indian stock exchange comes into effect from 31 December 2005. It has been formulated for the improvement of corporate governance in all listed companies. Clause 49 of Listing Agreements, as currently in effect, includes the following key requirements:

- Board Independence: Boards of directors of listed companies must have a minimum number of independent directors. Where the Chairman is an executive or a promoter or related to a promoter or a senior official, then at least one-half the board should comprise independent directors. In other cases, independent directors should constitute at least one-third of the board size.
- Audit Committees: Listed companies must have audit committees of the board with a minimum of three directors, two-thirds of whom must be independent. In addition, the roles and responsibilities of the audit committee are to be specified in detail.
- Disclosure: Listed companies must periodically make various disclosures regarding financial and other matters to ensure transparency.
- CEO/CFO certification of internal controls: The CEO and CFO of listed companies must (a) certify that the financial statements are fair and (b) accept responsibility for internal controls.
- Annual Reports: Annual reports of listed companies must carry status reports about compliance with corporate governance norms.

C. Voluntary Guidelines issued by Ministry of Corporate Affairs[5]

Voluntary Guidelines on Corporate Governance were issued by the Ministry of Corporate Affairs in December 2009. Few guidelines are worth mentioning.

1. Board of Directors

Appointment of Directors

- Companies should issue formal letters of appointment to Non-Executive Directors (NEDs) and Independent Directors as is done by them while appointing employees and Executive Directors. Such a formal letter should form a part of the disclosure to shareholders at the time of the ratification of his/her appointment or re-appointment to the Board.
- The offices of chairman of the board and chief executive officer should be separate.
- The companies may have a Nomination Committee comprised of a majority of Independent Directors, including its Chairman. A separate section in the Annual Report should outline the guidelines being followed by the Nomination Committee and the role and work done by it during the year under consideration.
- Independent Directors and NEDs should hold no more than seven directorships.

Independent Directors

- The Board should put in place a policy for specifying positive attributes of Independent Directors such as integrity, experience and expertise, foresight, managerial qualities and ability to read and understand financial statements. Disclosure about such policy should be made by the Board in its report to the shareholders. Such a policy may be subject to approval by shareholders.
- All Independent Directors should provide a detailed Certificate of Independence at the time of their appointment, and thereafter annually. Independent
Directors should be restricted to six-year terms. They must leave for three years before serving another term, and they may not serve more than three tenures for a company.
- Independent Directors should have the ability to meet with managers and should have access to information.

Remuneration of Directors
- NEDs should be paid either a fixed fee or a percentage of profits. Whichever payment method is elected should apply to all NEDs. NEDs paid with stock-options should hold onto those options for three years after leaving the board.
- Independent Directors should not be paid with stock options or profit-based commission.
- The Remuneration Committee should have at least three members with the majority of NEDs, and at least one Independent Director. Their decisions should be made available in the Annual Report.

2. Duties of the Board
- The Board should provide training for the directors.
- The Board should enable quality decision-making by giving the members timely access to information.
- The Board should put in systems of risk management and review them every six months.
- The Board should review its own performance annually and state its methods in its Annual Report.
- The Board should put in a system to ensure compliance with the law, which should be reviewed annually. All agenda items should be assessed for its impact on minority shareholders.

3. Audit Committee of Board
- The Audit Committee should be composed of at least three members, with Independent Directors in the majority and an Independent Director as the chairperson.
- The Audit Committee is responsible for reviewing the integrity of financial statements, the company’s internal financial controls, internal audit function and risk management systems. The Audit Committee should also monitor and approve all Transactions.
- The Committee may appoint an internal auditor.

5. Institution of a Mechanism for Whistle blowing
- The companies should ensure the institution of a mechanism for employees to report concerns about unethical behavior, actual or suspected fraud, or violation of the company’s code of conduct or ethical policy.
- The companies should also provide for adequate safeguards against victimization of employees who avail of the mechanism, and also allow direct access to the Audit Committee Chairperson in exceptional cases.

D. Amendments in Companies Act
The Companies Bill 2009 is expected to be brought before Indian Parliament for consideration in the forthcoming Budget session. The provisions of the Companies Bill is related to eligibility, power and function of Auditor and Audit Committee, appointment and qualification of Directors, Independent Directors, meeting of the board and its power.

V. Conclusion
Since the late 1990s, significant efforts have been made by the Indian Parliament, as well as by Indian corporations, to overhaul Indian Corporate Governance. The current Corporate Governance regime in Indian straddles both voluntary and mandatory requirements like Voluntary Guidelines by Ministry of Corporate Affairs. And for listed companies, the vast majority of Clause 49 of the listing agreements requirements is mandatory. The voluntary guideline on Corporate Governance by Ministry of Corporate Governance is a benchmark for the Corporate Governance practices in the Indian corporations, and hopefully the corporate world will make the best use of it. Efforts are also being made by the legislature to amend the Companies Act 1956. As a result, amendments relating to Corporate Governance are expected to be brought before Parliament in The Companies Bill 2009. India has one of the best Corporate Governance legal regimes but poor implementation together with socialistic policies of the pre-reform era has affected corporate governance.

References