CORPORATE GOVERNANCE IN INDIAN CONTEXT

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Abstract

Corporate governance has become crucial mechanism of governance for safeguarding markets and investor's interest.The need of corporate governance was realized in India after innumerable corporate frauds and scams. The reasons for misgovernance were limited access to global market, inefficiency in regulatory framework, lack of competition. There was a wind change in market dynamics after the introduction economic reforms.India has been actively promoting good governance to build confidence and trust of stakeholders of the corporations. This paper tries to attempt to study the efforts made by India to promote the corporate governance in the corporate world and to see the emerging challenges of good governance faced by Indian corporate world.

Keywords: India, Corporate Governance, Clause 49.

I Introduction

In Indian context, the need of corporate governance has been highlighted because of series of corporate frauds. The urgent need of induction of corporate governance is felt to reduce the scope of frauds and scams in the country. Corporate governance has become a topic of hot debate across the world because of its apparent and stringent importance for the well management of corporations. Corporate governance is a transparent and fair mechanism to govern markets and whereby all the stakeholders can commit their funds in corporations with full confidence and trust.Good corporate governance is the rules and practices that govern the relationship within that managers and stakeholders of corporations as well as stakeholders such as employees and creditors which contribute to the growth and financial stability by underpinning confidence, financial market integrity and economic efficiency (OECD 2004). Corporate governance is broadly defined as "a set of relationships between a company's board, its shareholders, and other stakeholders."The three major components of corporate governance are transparency, accountability and disclosures of information to shareholders and creditors.

Mckinsey report (2001) suggests two version of governance models which shows the governance practices followed in all over the world.

The first version model is known as market model which is followed in developed nations like US, UK, Canada and Australia. There are efficient and well developed markets. In this model, companies are following good governance practices with fairness and transparency and also there is separation of ownership and management. The governance practices of these economies are very well appreciated by the global investors.

The second version is known as control model which represents the underdeveloped nations capital markets, this model is widely followed in Asia, Latin America. The main characteristics of this model are underdeveloped capital markets, concentrated ownerships with less transparency.

In India the history of corporate governance dates back to the 1992, after the introduction of economic reforms and suggestions made by the Cadbury committee. The CII made voluntary code of corporate governance for listed companies in 1998. In 1999, Kumar managalam committee introduced the clause 49. Mandatory and non mandatory recommendations were the main issues of the committee. mandatory recommendations included issues pertaining to board formations like compositions,appointments of committees, compliance level of corporate governance in annual reports while non mandatory issues concerning setting of remuneration committee ,chairman of the board, appointment of nominee directors and obligations of institutional shareholders.

Over the years much stress has been given on the significance of corporate governance. The system of corporate governance differs from economy to economy in terms of stakeholders influence on management. The good corporate governance means managing the company while taking care of interest, trust and confidence of all stakeholders. Corporate governance is all about transparency, full disclosures and accountability.

II Objective The objective of this paper is to study the efforts made by India to promote the corporate governance in the corporate world and to see the major changes in corporate governance regulatory framework over the period of timeThis work has been analyzed on the basis of secondary data.

III Evolution of Corporate Governance in India With fall of corporate giants like Enron, WorldCom, Global crossing, Xerox and the consequent formation of Sarbanes Oxley Act were important drivers which stressed India to introduce stringent governance mechanism into the system for the regulation and administration of listed public limited companies

The concept of corporate governance was not a major agenda of Indian corporate 1990s. The corporate failures, unethical practices and lack of transparency were major reasons for the emergence of corporate governance in India. The concept gained momentum after economic reforms of 1991 so the history of corporate governance dates back to the year 1992.

3.1) The Companies Amendment Act, 2000 The major amendment to the Companies Act, 1956 were carried out by enacting the Companies (Amendment) Act 2000, which came into force with effect from 14th December 2000. This Act fulfilled some of the long standing demands of the corporate sector such as appointment of auditors, director's responsibility statement in director's report and disqualification of directors.

3.2) Kumar Mangalam Birla Committee, 1999 With a view to promote the governance, SEBI appointed a committee under the chairmanship Of Kumar Mangalam Birla in 1999. The key issues of agenda were:

To suggest suitable amendments in listing agreement regarding the disclosures of financial information.

- To draft best code of best practices.
- To deal with insider trading.

  The recommendations were consist of mandatory and non mandatory recommendations. The mandatory recommendations were related to applicability, board of director's w.r.t its composition and size, audit committee, remuneration committee, board procedures, management and shareholders. While non mandatory recommendations were related chairman of the board, remuneration committee, shareholder rights and postal ballot.

SEBI adopted the recommendations of the committee on corporate governance headed by the Kumar Mangalam Birla. Stock exchanges modified the listing requirements in accordance with the SEBI guidelines and form a new clause, clause 49 for ensuring corporate governance

3.3)) Naresh Chandra Committee, 2002 The department of company affairs (DCA) under the ministry of finance and company affairs appointed a high level committee under the chairmanship of Naresh Chandra to examine and recommend amendments to the law pertaining to auditor client relationships and role of independent directors. The committee took upon the task to analyze the various corporate governance issues such as

- the statutory auditor company relationship
- the need, if any for rotation of statutory audit
- the procedure for appointment of auditors and their fees
- restrictions on non audit functions, if any
- independence of audit functions
- disclosure of true picture of financial affairs
- certification of financial statements by management and directors
- random scrutiny of audited accounts
- role of independent directors

The committee intended to study and build upon its report following the benchmarks set by Sarbanes Oxley Law (SOX).

3.4 Narayan Murthy Committee, 2003 The Committee on Corporate Governance, headed by ShriNarayanmurthy was constituted by SEBI, to evaluate the existing corporate governance practices and to improve these practices as the standards themselves were evolving with market dynamics. The committee came out with two sets of recommendations, mandatory and non mandatory. Mandatory recommendations are concerned with the audit committee in which committee has to review the financial statements and draft audit reports, including quarterly/half yearly information, related party transactions, risk management, initial public offerings and code of conduct. Non mandatory recommendations are concerned with the moving to a regime providing for unqualified corporate financial statements, Training of board members and evaluation of non-executive director's performance by a peer group comprising the entire board of directors.

3.5) Birla Committee Report Clause 49(Amendments 2004) SEBI amended original clause 49 in 2004 in response to the Narayan Murthy committee recommendations and issued a new clause 49. All the listed companies have to comply with new clause 49. The provisions and requirement of clause 49 are pertaining to composition of board, constitution of board committee, and the audit committee, remunerations to directors, board procedures and shareholder information. The major difference between original clause and new clause is regarding with the qualification criteria of independent directors. Another major difference is powers of directors; new clause takes away the discretionary powers of the board.

Clause 49, 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 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.

Highlights of the new provisions incorporated in the new clause 49

- It is mandatory for the board to lay down the code of conduct for all board members and the senior management
- CEO and CFO will certify the financial statements and cash flow statements of the company
- at least one independent director of the holding company will be a member of the board of a material non listed subsidiary
- The audit committee shall review the financial statements of unlisted subsidiary, pertaining to its investments.

3.6) Establishment Of National Foundation Of Corporate Governance: National Foundation for Corporate Governance (NFCG) was set up in the year 2003 by the Ministry of

Corporate Affairs (MCA), in partnership with Confederation of Indian Industry (CII), Institute of Company Secretaries of India (ICSI) and Institute of Chartered Accountants of India (ICAI) to promote good Corporate Governance practices both at the level of individual corporates and Industry as a whole. In the year 2010, Institute of Cost Accountants of India (ICAI) and National Stock Exchange (NSE) were included in NFCG as Trustees. The vision of this trust is to be a Catalyst in Making India the Best in Corporate Governance Practices. The broad objective is to make significant difference to Indian Corporate Sector by raising the standard of corporate governance in India towards achieving stability and growth.

3.7) Corporate Governance And Ethics Committee, 2009 India witnessed a major scam of board failure and financial frauds of Satyam company. Consequently, Indian regulators devised new mechanism to address the concerns raised by Satyam .Under the chairmanship of Narayan Murthy, a new committee was formed corporate governance and ethics committee. The main members of committee were CII and NASSCOM. The committee issued its recommendations in 2010 focusing on stakeholders of the company. In early 2010, SEBI amended the Listing Agreement to add provisions related to the appointment of the CFO by the audit committee and other matters related to financial disclosures. However, other proposals such as rotation of audit partners were not included in the amendment of the Listing Agreement.

Ministry of corporate affairs actions: Inspired by industry recommendations, including the influential CII recommendations, in late 2009 the MCA released a set of voluntary guidelines for corporate governance. The Voluntary Guidelines address corporate governance matters includes independence of the boards of directors responsibilities of the board, the audit committee, auditors, secretarial audits; and mechanisms to encourage and protect whistle blowing.

The evolution of the corporate governance guidelines in the global context and from the perspective of progress made in India is given in the chart below.

Table 1: Evolution of the Corporate Governance

Cadbury Report, United Kingdom 1995	The objective of the Cadbury committee was to investigate how large public companies should adopt corporate governance guidelines with a focus on the procedures of financial report production and the role of the accounting profession. Issues included the role of

	the board of directors, standards of financial reporting, accountability of the auditors and directors pay.
Greenbury Report, United Kingdom, 1995	The report dealt with the remuneration of executives and non-executives board members and recommended the setting up of a remuneration committee in each public company to determine remuneration packages for the board members. It also provided suggestions on the disclosure of remuneration and the setting up of remuneration policy and service contracts and compensation.
Hampel Report, United Kingdom, 1998	Four major issues were discussed with practical guidelines offered; (a) the role of directors (b) directors compensation (c) the role of shareholders (d) accountability and audit.
CII Voluntary Code of Corporate Governance,1998	The first of the voluntarily evolved codes in India.
Kumara Mangalam Birla Committee, India, 1999	The mandatory recommendations of the Kumar Mangalam committee include the constitution of Audit Committee and Remuneration Committee in all listed companies, appointment of one or more independent directors in them, recognition of the leadership role of the Chairman of a company, enforcement of Accounting Standards, the obligation to make more disclosures in annual financial reports, effective use of the power and influence of institutional shareholders, and so on. The Committee also recommended a few provisions, which are non- mandatory.
Sarbanes-Oxley Act, 2002	A major initiative of corporate compliance, the Sarbanes-Oxley Act of 2002, is also known as the

	Public Company Accounting Reform and Investor Protection Act of 2002 is a US federal law that has main features such as ; establishment of the Public Company Accounting Oversight Board (PCAOB), auditors independence, corporate responsibility, enhanced financial disclosures, analyst conflict of interest, commission resources and authority, corporate and criminal fraud accountability, while collar crime penalty enhancement, corporate tax returns and corporate fraud accountability.
Higgs Report, 2003	On non-executive directors.
Smith Report, 2003	On Audit Committees.
Narayana Murthy Committee, 2002	The key mandatory recommendations focus on strengthening the responsibilities of audit committees; improving the quality of financial disclosures, including those pertaining to related party transactions and proceeds from initial public offerings; requiring corporate executive boards to assess and disclose business risks in the annual reports of companies; introducing responsibilities on boards to adopt formal codes of conduct; the position of nominee directors; and stock holder approval and improved disclosures relating to compensation paid to non-executive directors. Non-mandatory recommendations include moving to a regime where corporate financial statements are not qualified; instituting a system of training of board members; and the evaluation of performance of board members.
Naresh Chandra Committee,2003	The auditor-company relationship, Auditing the auditors Independent directors: Role, remuneration and training.

OECD Principles,2004	The OECD Principles cover five aspects of governance (a) the rights of shareholders (b) the equitable treatment of shareholders (c) the role of stakeholders (d) disclosure and transparency (e) the responsibilities of the board.
Clause 49 of the Listing Agreement, 2005	A major compliance directive that came into force from the quarter ended June 2005, it has major aspects of compliance by listed companies that include; definition of independent directors; Non-Executive Director's compensation and disclosures, other provisions as to Board and Committees, Code of Conduct, Composition of Audit Committee, Meeting of Audit Committee, Subsidiary Companies, Disclosures pertaining to (a) basis of related transactions (b) accounting treatment (c) risk management (d) proceeds from public/rights/preferential issues (e) remuneration of directors and management discussion and analysis, CEO/CFO Certification, report on corporate governance, auditors certificate on compliance etc.

IV Current Structure of Corporate Governance in India

The Indian Companies Act of 2013 introduced some progressive and transparent processes which benefit stakeholders, directors as well as the management of companies. Investment advisory services and proxy firms provide concise information to the shareholders about these newly introduced processes and regulations, which aim to improve the corporate governance in India.

Corporate governance was guided by Clause 49 of the Listing Agreement before introduction of the Companies Act of 2013. As per the new provision, SEBI has also approved certain amendments in the Listing Agreement so as to improve the transparency in transactions of listed companies and giving a bigger say to minority stakeholders in influencing the decisions of management. These amendments have become effective from 1st October 2014.

New Provisions are:

- One or more women directors are recommended for certain classes of companies
- Every company in India must have a resident directory
- The maximum permissible directors cannot exceed 15 in a public limited company. If more directors have to be appointed, it can be done only with approval of the shareholders after passing a Special Resolution
- The Independent Directors are a newly introduced concept under the Act. A code of conduct is prescribed and so are other functions and duties
- The Independent directors must attend at least one meeting a year
- Every company must appoint an individual or firm as an auditor. The responsibility of the Audit committee has increased
- Filing and disclosures with the Registrar of Companies has increased
- Top management recognizes the rights of the shareholders and ensures strong co-operation between the company and the stakeholders
- Every company has to make accurate disclosure of financial situations, performance, material matter, ownership and governance

Table 2: Major features of the Corporate Governance in India

	Legal Framework	Companies Act, 1956 and Clause 49 of the Listing Agreement of Stock Exchanges
	Voting Rights	All shareholders have the right to vote. Proxy voting allowed. Companies allowed to issue shares with multiple voting rights or dividends
	Firm Capital Structure	Requires board/shareholder approval to change capital structure. A merger needs 75% of the shareholder vote
	Shareholder Meetings	It is required to hold AGM every year. Allows shareholders controlling 10% of voting rights or paid up capital to call a special or Extra

		Ordinary General Meeting
	Board Structure	One third of the board should be non executive and a majority of these independent. In case where the Chairman of the board is an executive, 50 % of the board be comprised of independent directors
	Board Meetings	The Board should meet at least four times a year. 33% of the board members or two members, whichever is greater, be present. All fees and compensation paid to the non-executive directors require prior approval of the shareholders in the AGM
	Election of Directors	The directors of the Board be approved and appointed by the company in the Annual General Meeting.
	Board Committees	Every board is required to have a shareholder grievance committee and an audit committee. Remuneration committee is non-mandatory
	Disclosure	Every company to have a compliance officer responsible for setting policies, procedures and monitoring adherence. SEBI has established an insider trading committee to monitor the same. Companies required to disclose information through annual reports/websites etc., Management Discussion Analysis, a part of the Annual Report
	Accounting	Shareholders to appoint an independent auditor, certified by Institute of Chartered Accountants of India. Accounting standards comply with International Accounting Standards (IAS) and International Financial Reporting Standards

		(IFRS). Companies conduct comprehensive audits annually.
	Audit Committees	Audit Committee to have a minimum of three members, of which two-thirds be independent directors and at least one members should have accounting/finance background. Audit Committee also reviewed internal control systems
	Related Party Transactions	Clause 49 required listed companies to disclose material significant related party transactions to shareholders.
	Whistle Blower Policy	Right of access to all employees. Direct access to audit committee without informing the superiors.

Source: Stock Exchanges, Institute of International Finance

V Emerging Challenges

The complete fallout of recent TATA leadership, shows that Indian corporate governance landscape need to set a good example. While India has strong and lengthy rule books but still there are several challenges exist in the governance landscape.

- There is mandatory requirement in Companies Act 2013 that at least one female must be a director in the board of directors to increase the women participation at board level but the concern is that they are appointing women belonging to the families which are controlling the companies.
- It has also mandated that there must be a Corporate Social Responsibility (CSR) committee constituted by the board and company should spend 2 percent of net profit on CSR activities. In reality, some companies are abusing CSR norms by fabricating CSR spending. Law should be tightened to ensure that there is no leakage of funds.
- Boards are expected to take an active role in cyber security. Board need to ensure that the companies are taking preventing measures for cyber security threats because cyber threats have far reaching impact on the, financials and the reputation of the firm so this is the most challenging risk for the directors.

- The 2013 Companies Act brought a paradigm shift by enhancing the duties and liabilities of directors and imposition of stringent penalties in case of any breach of provisions.This Act imposed many obligations on the directors of a company and also increased the accountability but these changes increase the personal risk of directors.

VI Looking Ahead

India has a long way to be ranked the best in the world. Considering the role of regulatory system in India, it has played a pivotal role in enhancing corporate governance standards.There is constant need to review the systems in achieving corporate excellence. The current status of Indian corporate is to follow both voluntary and mandatory requirements of corporate governance. Indian companies are encouraged to maintain best corporate standards and abreast with the emerging issues. No doubt Indian regulatory authorities have taken initiatives to overhaul the system by adopting code of corporate governance and Indian corporations are increasingly putting in practices but at the same time they have to face some challenges to sustain in global arena.Good corporate governance is not an option but it is fundamental for running business.

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