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Odisha State Open University, Sambalpur, Odisha

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MANAGEMENT PROGRAMME

MP-12

Ethics, Governance & Social Responsibility

Block

2

Corporate Governance

Unit-I

Corporate Governance: An Overview

Unit-II

Committees on Corporate Governance

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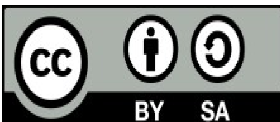

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Unit – I
Corporate Governance: An Overview

Learning Objectives

After completion of the unit, you should be able to:

- Understand the concept and definition of Corporate Governance.
- Appreciate the evolution/history of Corporate Governance.
- Know the scope and importance of Corporate Governance.
- Understand the objectives and benefits of Corporate Governance.
- Appreciate the principles of Corporate Governance.
- Understand the Corporate Governance Model.

Structure

1.1 Introduction
1.2 Definitions
1.3 Evolution/History of Corporate Governance
1.4 Pre-requisites of Good Governance
1.5 Objectives of Corporate Governance
1.6 Scope and Importance of Corporate Governance
1.7 Benefits of Corporate Governance
1.8 Issues in Corporate Governance
1.9 Principles of Corporate Governance
1.10 Model on Corporate Governance
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1.12 Key Terms
1.13 Self-Assessment Questions
1.14 Further Readings
1.15 Model Questions

1.1 Introduction

A corporation without governance is like a train without a track. No matter how much potential the business has, it will never undergo the business transformation needed to get to where it wants because it has nothing directing its progress. Unfortunately, corporate governance didn't get much attention until 2002, when President Bush signed the Sarbanes-Oxley Act into law. The Act issued a number of reform intended to improve corporate responsibility and prevent financial frauds. American companies like Enron and WorldCom committed deliberate frauds which created fear in the minds of many investors losing their money if corporations continued to mismanage their funds

and investments. Today however, proper governance is not simply about investor security, it is necessary for corporations to succeed.

Corporate governance is the system of rules, practices and processes by which a company is directed and controlled. Corporate Governance is the interaction between various participants (shareholders, board of directors, and company's management) in shaping corporation's performance and the way it is proceeding towards. The relationship between the owners and the managers in an organization must be healthy and there should be no conflict between the two. The owners must see that individual's actual performance is according to the standard performance. These dimensions of corporate governance should not be overlooked. Corporate Governance deals with determining ways to take effective strategic decisions. It gives ultimate authority and complete responsibility to the Board of Directors. In today's market- oriented economy, the need for corporate governance arises. Also, efficiency as well as globalization is significant factors urging corporate governance. Corporate Governance is essential to develop added value to the stakeholders.

1.2 Meaning and Definitions of Corporate Governance

Corporate Governance refers to the way a corporation is governed. It is the technique by which companies are directed and managed. It means carrying the business as per the stakeholders' desires. It is actually conducted by the board of Directors and the concerned committees for the company's stakeholder's benefit. It is all about balancing individual and societal goals, as well as, economic and social goals.

"Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the board, managers, shareholders and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides this; it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance."

Definition of corporate governance by the Institute of Company Secretaries of India is as under:

"Corporate Governance is the application of best Management practices, Compliance of law in true letter and spirit and adherence to ethical standards for Effective Management and distribution of wealth and discharge of social Responsibility for sustainable development of all stakeholders".

According to James. D. Wolfensohn, World Bank President," Corporate Governance is about promoting corporate fairness, transparency and accountability."

According to Sir Adrian Cadbury, World Bank Publication," Corporate Governance is holding the balance between economic and social goals and between individual and community goals."

According to SEBI committee," Corporate Governance is the system by which the companies are directed and controlled by the management in the best interest of the stakeholders and others, ensuring greater transparency and better and timely financial reporting."

According to Cadbury Report (UK)," Corporate Governance is the system by which businesses are directed and controlled."

1.3 Evolution/History of Corporate Governance

Evolution of Corporate Governance in Abroad

In the beginning of the new millennium, several companies that were held as role models in corporate governance collapsed because of corporate misgovernance like accounting irregularities and fraudulent practices. The existing regulatory framework appeared to be inadequate to deal with the gigantic business conglomerates such as Xerox, WorldCom, Enron that committed deliberate frauds with a view to boost their sales revenues and to show highly inflated profits. In the year 2000, several American mega corporations collapsed like a pack of cards. For example- WorldCom, Enron, Anderson, Dynegy Waste Management, Adelphia Communications, Tyco, Rite Aid, Peregrine Systems. These companies were involved mainly in accounting and trading malpractices/frauds.

The Federal Administration of bush slapped punitive measures on every erring corporation and initiated preventive steps to avoid corporate frauds in future. In the light of the corporate frauds, the new law has come into force, known as the **Sarbanes-Oxley Act.** This act made it mandatory for senior executives to certify annual and quarterly reports. This certification means that these officials will be liable for criminal or civil suits for ant omissions, false statements and restatements.

Corporate Misgovernance in India- Series of Scams that shook Investor Confidence.

India also witnessed corporate misgovernance that shook investor confidence like Harshad Mehta's securities scam, disappearance and vanishing companies scam, Plantation companies scam, NBFCs scam, mutual fund scam, BPL, Sterlite and Videocon committing corporate frauds, IT Scams using names like 'Infotech' to mislead gullible investors, Ketan Parekh scam in 2001.

It can be explained in the following points:

1. In India, whilst management processes were widely explored, till recently relatively little attention was paid to the processes by which companies were governed. The various aspects to this crept into India after the report of the Cadbury Committee in U.K. in 1992, which evoked considerable interest in Indian companies.
2. The Confederation of Indian Industries (CII) thereafter published a Desirable Code of Corporate Governance, which some companies voluntarily adopted.
3. The issue came into prominencewith the report of Shri Kumar Mangalam Birla Committee set up by SEBI to suggest changes in the listing agreement to promote corporate governance.
4. SEBI initiated several steps for strengthening corporate governance through the amendment of the listing agreement.
5. However, SEBI continued to receive a large number of investor complaints daily. To further improve the level of corporate governance, it was felt that a more comprehensive approach was needed at that stage of development of the capital market.
6. This prompted SEBI to constitute a Committee under the chairmanship of Shri Kumar Mangalam Birla, to suggest changes in the Listing Agreement to promote corporate governance.
7. The Committee’s report wasmade public. Based on the recommendations of the Committee and the feedback received, the SEBI Board at its meeting held on January 25, 2000 considered the recommendations of the Committee and decided to make amendments to the Listing Agreement in pursuance of these recommendations.
8. It was advised that a new clause, namely clause 49 be incorporated in the agreement covering the following primary areas:

    i. Board of Directors (specifying a minimum number of independent directors and board procedures).
    ii. Audit Committee (introducing the mandatory requirement of an audit committee and its roles and responsibilities).
    iii. Director’s remuneration (disclosures of Director’s remuneration).
    iv. Disclosures (mandatory Management Discussion and Analysis section in Annual Reports and other disclosures).

Broadly, eight points on which provisions were included:

- Board of Directors and its composition
- Audit Committee
- Remuneration of Directors
- Board Procedure
- Management Discussion and Analysis Report
- Shareholders/Investors Grievance Committee and Other Stakeholders’
- Report on Corporate Governance

- Certificate of Compliance

10. In August 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, Former Cabinet Secretary "to examine the Auditor-Company relationship, role of independent directors, disciplinary mechanism over auditors in the light of regularities committees by companies in India and abroad."

(a) In late 2002, SEBI having analysed the disclosures made by companies under clause 49 and after a review of a large number of company's annual report, observed that there was considerable variance in the extent and quality of disclosures made by companies in their annual reports and concluded that there was a need to review the extent and quality of disclosures made by companies in their annual reports and concluded that there was a need to review the existing code on corporate governance to assess adequacy of existing practices.

(b) Suggest improvements to the existing practices. Thus, the SEBI Committee on corporate governance was constituted under the chairmanship of N R Narayan Murthy to look into thses matters.

(c) The Murthy Committee report (February 2003), reviewed existing best practices in corporate governance and also drew upon the recommendations of the Kumar Mangalam Birla Committee and the Naresh Chandra Committee to recommend further improvements in the existing system of corporate governance applicable to Indian companies.

The Revised Clause 49

In October 2004, SEBI amended Clause 49 of the listing agreement in alignment with the recommendations of the Narayan Murthy Committee. These changes primarily strengthened the requirements in the following areas:

i. Board composition and procedure
ii. Audit committee responsibilities
iii. Subsidiary companies
iv. Risk management
v. CEO/CFO certification of financial and internal controls
vi. Legal compliance
vii. Other disclosures.

Since large numbers of companies were not in a state of preparedness to fully comply with the requirements of the Revised Clause 49, it was felt that more time should be allowed to them, to confirm to the provisions of the Revised Clause 49. Accordingly, SEBI has extended the date for ensuring compliance with the Revised Clause 49 of the Listing Agreement to December 31, 2005.

1.4 Pre-requisites of Good Governance

Good governance has eight major characteristics. It is participatory, consensus oriented, accountable, transparent, responsive, effective and efficient, equitable and inclusive, and follows the rule of law. Good governance is responsive to the present and future needs of the organization, exercises prudence in policy-setting and decision-making, and that the best interests of all stakeholders are taken into account.

1. Rule of Law

Good governance requires fair legal frameworks that are enforced by an impartial regulatory body, for the full protection of stakeholders.

2.Transparency

Transparency means that information should be provided in easily understandable forms and media; that it should be freely available and directly accessible to those who will be affected by governance policies and practices, as well as the outcomes resulting therefrom; and that any decisions taken and their enforcement are in compliance with established rules and regulations.

3. Responsiveness

Good governance requires that organizations and their processes are designed to serve the best interests of stakeholders within a reasonable timeframe.

4. Consensus Oriented

Good governance requires consultation to understand the different interests of stakeholders in order to reach a broad consensus of what is in the best interest of the entire stakeholder group and how this can be achieved in a sustainable and prudent manner.

5. Equity and Inclusiveness

The organization that provides the opportunity for its stakeholders to maintain, enhance, or generally improve their well-being provides the most compelling message regarding its reason for existence and value to society.

6. Effectiveness and Efficiency

Good governance means that the processes implemented by the organization to produce favourable results meet the needs of its stakeholders, while making the best use of resources – human, technological, financial, natural and environmental – at its disposal.

7. Accountability

Accountability is a key tenet of good governance. Who is accountable for what should be documented in policy statements. In general, an organization is accountable to those who will be affected by its decisions or actions as well as the applicable rules of law.

8. Participation

Participation by both men and women, either directly or through legitimate representatives, is a key cornerstone of good governance. Participation needs to be informed and organized, including freedom of expression and assiduous concern for the best interests of the organization and society in general.

Towards Improved Governance:

Good governance is an ideal which is difficult to achieve in its totality. Governance typically involves well-intentioned people who bring their ideas, experiences, preferences and other human strengths and shortcomings to the policy-making table. Good governance is achieved through an on-going discourse that attempts to capture all of the considerations involved in assuring that stakeholder interests are addressed and reflected in policy initiatives.

1.5 Objectives of Corporate Governance

1. To enhance the long term value and economic efficiency of the company. It encompasses all shareholders and integrates all the participants involved in the process.
2. To elevate the reputation of the corporation and the esteem of its management.
3. To attract, employ and retain talent and motivate employees to give their best. A more open and participative style of management ensures free exchange of ideas and frank appreciation at all levels.
4. To create and adopt code of conduct with wholehearted commitment and improve the moral and ethical standards of performance to the utmost level.
5. To have a right balance, knowledge and competence to set strategies and lead the organisation.
6. To use the resources entrusted to the management, in most economic and efficient productive and effective ways, for the benefit of shareholders as well as for the society at large.
7. To set the high standards of business ethics based on humanity, honesty and hardwork.
8. Top improve the standards of living and life of the society, industry, commerce, services and professionals at large.
9. To generate accurate and reliable information.
10. To make decision-making process transparent.

1.6 Scope and Importance of Corporate Governance

Corporate governance has wide ramification and extends beyond good corporate performance and financial property though these are no doubt essentials. In India, corporate governance has been under scrutiny and is an issue that has gained widespread importance.

The need and importance of corporate governance can be best conveyed with the following quotation of Benjamin Franklin:

"A little neglect may breed great mischief- for the want of a nail, the shoe was lost; for the want of a shoe, the horse was lost; for the want of a horse, the rider was lost; and for the want of a rider, the battle was lost."

The importance of corporate governance is as follows:-

1. It prepares a small enterprise for growth and helps to secure new business opportunities when they arise.
2. It increases the company's ability to identify and mitigate risks, manage crisis, respond to changing market trends.
3. It increases market confidence as a whole and improves economic efficiency of a firm.
4. Boards are accountable to the company and shareholder, thus the society as a whole is benefited.
5. The credibility of corporate governance attracts long-term capital foreign as well as domestic.
6. It ensures purity and quality of product after the product leaves the factory.
7. It improves norms for the relationships between company management, its board, shareholders, owners, employees, suppliers, customers and the public.
8. It also provides a structure through which the objectives of the company are set.
9. It enhances the long-term value of the company for its shareholders and all patrons.
10. It integrates all the participants involved in a process which is economic, at the same time social.
11. A balance between economic and social objectives and the reconciliation of the interests of the individuals, the company and society is achieved.
12. Good corporate governance helps an organisation to achieve its outcomes and obligations through sound planning and risk management.
13. It provides a means to assist in decision-making and to improve accountability.
14. It helps to provide a framework for establishing responsibility to the organisation's members, the people served by the organisation and other stakeholders.

1.7 Benefits of Corporate Governance

Corporate Governance is now being increasingly practiced by companies across the globe due to the number of benefits it offers. Practicing corporate governance is

beneficial for a company and its stakeholders as well for the economy as a whole. A few benefits of corporate governance are mentioned below.

Excellent Management

If a company is practicing corporate governance, people not linked to the firm will also be able to assess its governance. This is because the most fundamental principle of corporate governance is transparency and the principles of disclosure. Every step taken by company authorities, having control over the company's management, is in the best interests of the company and its stakeholders. This has a positive impact on the community and may reflect upon the market valuation of the firm and hence, its share price.

High Level of Transparency

Companies that follow a set of best practices are encouraged to be highly transparent about their business. This helps them attain the trust of the community and its stakeholders and eases the task of raising capital, when needed. As the business is easy to assess and evaluate due to its high level of transparency, many investors and financial institutions prefer funding these companies than those that are not following the core principles of corporate governance.

Stakeholder Benefits

Under corporate governance, a firm tends to act in the best interest of the firm and its stakeholders. This will ensure greater success as the goal of the company managers will now be aligned with the goals of the company. The result of this will be greater profits and faster growth which will benefit the company and all the stakeholders.

Reputation and Recognition

The practice of good corporate governance followed by firms will allow them to gain the trust of the investors, the customers and the community at large. This will have a positive impact on the company's reputation and it will be recognized as a fair and transparent company. This image will help the company prosper in the long run and achieve its goals more quickly.

Reduces Wastage

Good practices of corporate governance help companies become more efficient in their business. Employees that are trained to follow ethical business practices will avoid excess wastage of company resources will tend to utilize all resources optimally.

Reduce Risks, Mismanagement and Corruption

A company can reduce the amount of risks in their business as well as any attempts of corruption and mismanagement by following the practices of good

governance. Due to the amount of transparency necessary in companies that follow the principles of good governance, many individuals intending to misuse their position and power will be unable to do so. This will reduce the overall incidences of negative acts in the company and help it achieve success and a positive image in the community.

Economic Benefit

A company following good corporate governance will be able to achieve the trust of the community and hence, success in the long run. A firm's good reputation will ensure a good flow of capital by attracting foreign investors in the economy and will benefit the economic situation of the nation.

1.8 Issues in Corporate Governance

Corporate governance has been defined in different ways by different writers and organisations. Some define it in a narrow perspective to include in it only the shareholders, while others want it to address the concerns of all stakeholders. Some consider corporate governance as an instrument for a country to achieve sustainable economic development, while others consider it as a corporate strategy to achieve a long tenure and a healthy image. To some, it provides another dimension to corporate ethics and social responsibility of business. Thus, all authorities on the subject are one in recognising the need for good corporate governance practices to achieve the end for which corporates are formed. There are some governance issues being crucial and critical to achieve these objectives. These are:

1. Distinguishing the roles of board and management.
2. Composition of the board and related issues.
3. Separation of the roles of the CEO and chairman
4. Should the board have committees
5. Appointments to the board and directors' re-election
6. Directors' and executives' remunerations
7. Disclosure and audits
8. Protection of shareholder rights and their expectations
9. Dialogue with institutional shareholders
10. Should investors have a say in making a company "socially responsible corporate citizen"?

1. Distinguishing the roles of board and management:

The board occupies a key position between the shareholders (owners) and the company's management (day-to-day managers of the company's resources). The board of a listed company has the following functions:

a) Select, decide the remuneration and evaluate on a regular basis, and when necessary, change the CEO.
b) Oversee (not directly, but indirectly) the conduct of the company's business to evaluate whether or not it is being correctly managed.
c) Review and where necessary approve the company's financial objectives and major corporate plans and objectives.
d) Render advice and counsel to top management.
e) Review the adequacy of systems to comply with all applicable laws and regulations.

2. Composition of the board and related issues:

A board of directors is a "committee elected by the shareholders of a limited company to be responsible for the policy of the company. Sometimes, full-time functional directors are appointed, each being responsible for some particular branch of the firm's work." The composition of board of directors refers to the number of directors of different kinds that participate in the work of the board.

3. Separation of the role of the CEO and chairperson:

In the countries like the US and India, there is a practice of combining the role of the chairperson with that of the CEO leads to conflicts in decision-making and too much concentration of power in one person resulting in unsavoury consequences. In the United Kingdom and Australia, the CEO is prohibited from being the chairperson of the company. The role of the CEO is to lead the senior management team in managing the enterprise, while the role of the chairman is to lead the board, one important responsibility of the Board being to evaluate the performance of the senior executives including the CEO. Combining the role of both the CEO and the chairperson removes an important check on senior management's activities. That's the reason why, many authorities on corporate governance recommend strongly that the chairman of the board should be an independent director in order to "provide the appropriate counterbalance and check the power of the CEO."

4. Should the board have committees?

Many committees on CG have recommended appointment of special committees for: nomination, remuneration, and for auditing. As these committees lessens the burden of the board and enhances their effectiveness.

5. Appointments to the board and directors' re-election:

As per the Indian Company Law, shareholders elect directors to the board. However, shareholders are legion in large companies and also scattered and to have them together to elect the directors will be expensive and time-consuming. Therefore, in actual

practice, in most cases, the board or its specially constituted committee selects and appoints the prospective director and get the person formally "elected" by the shareholders at the ensuing Annual General Body Meeting.

6. Directors' and executives' remuneration:

The key corporate governance issues under this head are: transparency, pay for performance (whether the payment is justified), process of determination of compensation, severance payments and pensions for non-executive directors.

7. Disclosure and audit:

The OECD lays down a number of provisions for the disclosure and communication of key facts about the company to its shareholders. The Cadbury Report termed the annual audit as "one of the cornerstones of corporate governance." Audit also provides a basis for reassurance foe everyone who has a financial stake in the company. The several issues relating to auditing which have an impact on corporate governance are such as: (a) should board establish an audit committee? (b) if yes, how should it be composed? (c) how to ensure the independence of auditor? (d) what precautions are to be taken or what are the positions of the state and regulators with regard to provision of non-audit services rendered by auditors?

8. Protection of shareholder rights and their expectations:

This is an important governance issue which has considerable impact on the rights and expectations of shareholders. There are a number of questions relating to this issue such as: (a) should companies always adhere to one-share-one-vote principle? (b) should companies retain voting by show of hand or by poll? (c) can shareholder's resolutions be "bundled"? (d) should shareholder approval be required for all major transactions?

9. Dialogue with institutional shareholders:

Institutional shareholders are the outsider institutional investors whose money have been invested in the companies. The Cadbury Committee recommends that institutional investors should maintain regular and systematic contact with companies, apart from participation in general meetings of shareholders, use their rights to vote positively, take a positive interest in the composition of board of directors of the company in which they invest, and above all, recognise their rights and responsibilities as "owners" who should act in the best interests of those whose money have been invested rather than by selling their shares, and quitting the companies.

10. Should investors have a say in making a company "socially responsible corporate citizen"?

The major corporate concerns towards humanity are ecological preservation, anti-pollution measures and producing quality and environment-friendly products which always enhance costs and reduce profits. While others assert environment friendliness

and economic gains are not contradicting goals, but on the other hand, they benefit corporations in the long run.

1.9 Principles of Corporate Governance

The Cadbury Report which was released in the UK in 1991 outlined that "Corporate governance is the system by which businesses are directed and controlled." Good corporate governance is a key factor in underpinning the integrity and efficiency of a company. Poor corporate governance can weaken a company's potential, can lead to financial difficulties and in some cases can cause long-term damage to a company's reputation. A company which applies the core principles of good corporate governance; fairness, accountability, responsibility and transparency, will usually outperform other companies and will be able to attract investors, whose support can help to finance further growth.

Outlining the role of each principle.

1. **Fairness**: Fairness refers to equal treatment, for example, all shareholders should receive equal consideration for whatever shareholdings they hold. In the UK this is protected by the Companies Act 2006 (CA 06). However, some companies prefer to have a shareholder agreement, which can include more extensive and effective minority protection. In addition to shareholders, there should also be fairness in the treatment of all stakeholders including employees, communities and public officials. The fairer the entity appears to stakeholders, the more likely it is that it can survive the pressure of interested parties.

2. **Accountability**: Corporate accountability refers to the obligation and responsibility to give an explanation or reason for the company's actions and conduct.
   In brief: -The board should present a balanced and understandable assessment of the company's position and prospects.
   -The board is responsible for determining the nature and extent of the significant risks it is willing to take;
   -The board should maintain sound risk management and internal control systems;
   -The board should establish formal and transparent arrangements for corporate reporting and risk management and for maintaining an appropriate relationship with the company's auditor, and
   -The board should communicate with stakeholders at regular intervals, a fair, balanced and understandable assessment of how the company is achieving its business purpose.

3. **Responsibility**: The Board of Directors are given authority to act on behalf of the company. They should therefore accept full responsibility for the powers that

it is given and the authority that it exercises. The Board of Directors are responsible for overseeing the management of the business, affairs of the company, appointing the chief executive and monitoring the performance of the company. In doing so, it is required to act in the best interests of the company. Accountability goes hand in hand with responsibility. The Board of Directors should be made accountable to the shareholders for the way in which the company has carried out its responsibilities.

4. **Transparency**: A principle of good governance is that stakeholders should be informed about the company's activities, what it plans to do in the future and any risks involved in its business strategies. Transparency means openness, a willingness by the company to provide clear information to shareholders and other stakeholders. For example, transparency refers to the openness and willingness to disclose financial performance figures which are truthful and accurate.

   Disclosure of material matters concerning the organisation's performance and activities should be timely and accurate to ensure that all investors have access to clear, factual information which accurately reflects the financial, social and environmental position of the organisation. Organisations should clarify and make publicly known the roles and responsibilities of the board and management to provide shareholders with a level of accountability. Transparency ensures that stakeholders can have confidence in the decision-making and management processes of a company.

1.10 Models on Corporate Governance

Models of governance vary widely across counties for understandable reasons. The uniqueness of history, cultural and institutional factors and the habits and attitudes of the people influence their approach towards corporate governance. Since the attainment of independence in India the government, regulatory agencies, and the major providers of capital in the country and legacies from the Britain rule have influenced the model of corporate governance. Broadly we can categorise the models of corporate governance under four models.

- The Anglo American model
- The German Model
- The Japanese model
- The Indian model

1. The Anglo American Model

In this model the board appoints and supervises the managers who manage the day-to-day affairs of the corporations.While the legal system provides the structural framework, the stakeholders in the company will be supplies, employees and creditors. However, creditors exercise their lien over the assets of the company. The policies are

framed by the board of directors and implemented by the management. The theme of this model can be depicted as follows:

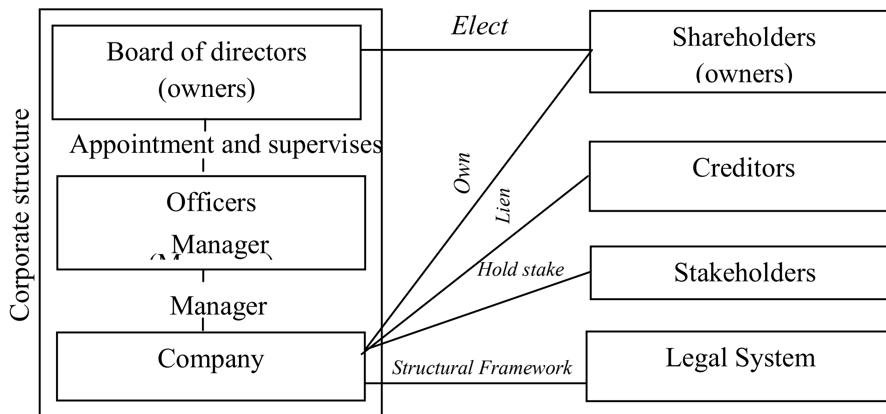


Chart-1: Anglo-American model of corporate governance

The features of the Anglo American Model are:

- Clear separation of ownership and management, which minimises conflicts of interests.
- Professional managers who have negligible ownership stakes linked to performance-run companies. CEO has major role to play.
- Capital markets are quite active.
- Short-term action is pervasive.
- There exists a fairly active market for corporate takeover and control.
- If the company is poorly managed it is exposed to takeover threats.

The German Model

In this model the shareholders own the company; they don't entirely dictate the governance mechanism. The shareholders elect 50% members of the supervisory board and the other half is appointed by labour unions. This ensures the employees and labourers to enjoy the share in the governance. The supervisory board appoints and monitors the management board. There is a reporting relationship between them, although the management board independently governs the day-to-day operations of the company. The theme of this model can be depicted as follows:

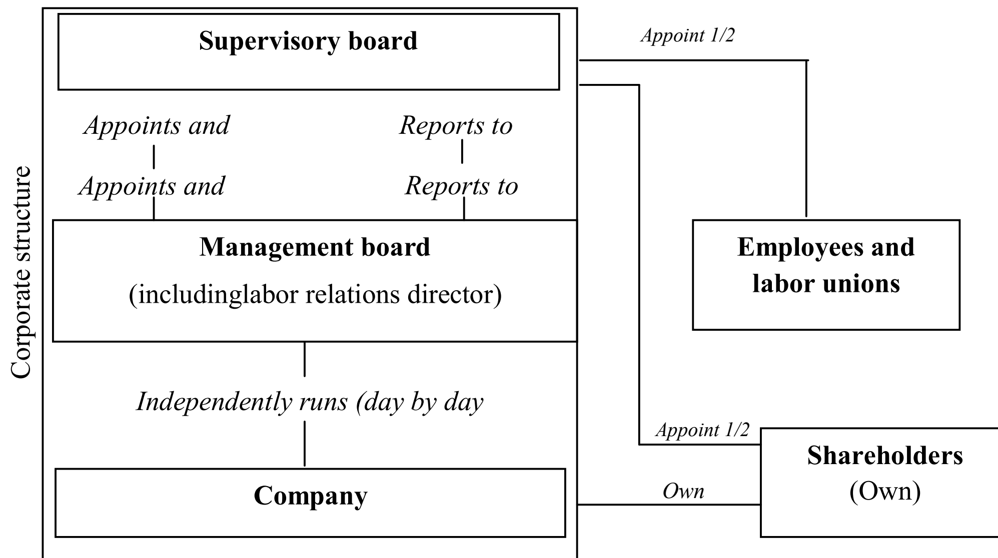


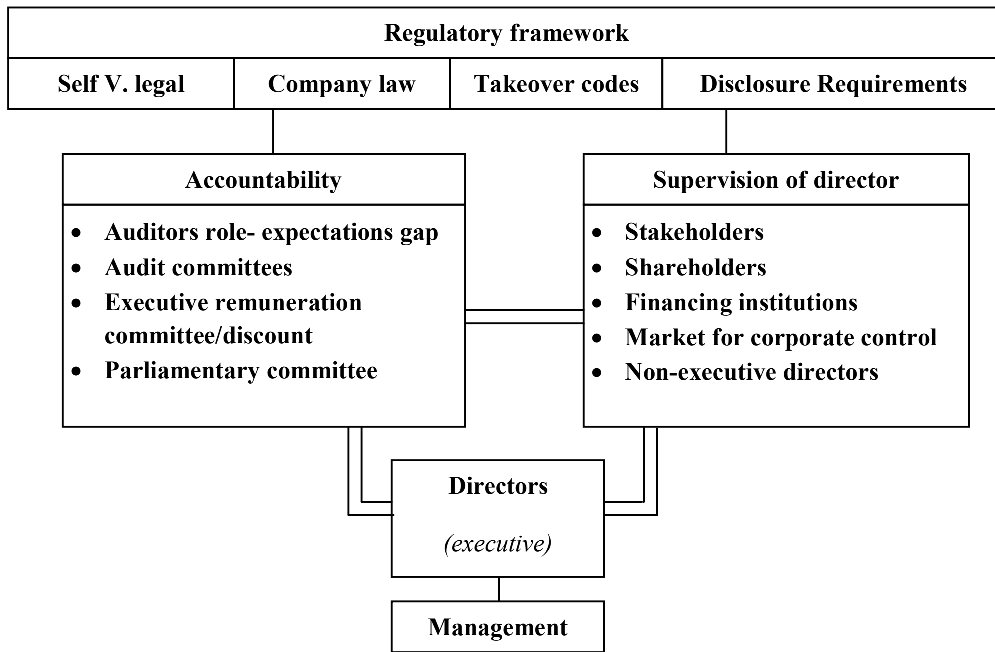
Chart-II: German model of corporate governance

The features of the German model are as follows:

- Banks and financial institutions have substantial stakes in the company.
- Labour relations officer is represented in the management board. Worker's participation in management is essential.
- Both shareholders and employees have equal say in selecting the members of the supervisory board.

The Japanese Model

The shareholders and the banks together appoint the board of directors and the president. It can easily figure out with the help of the diagram below:

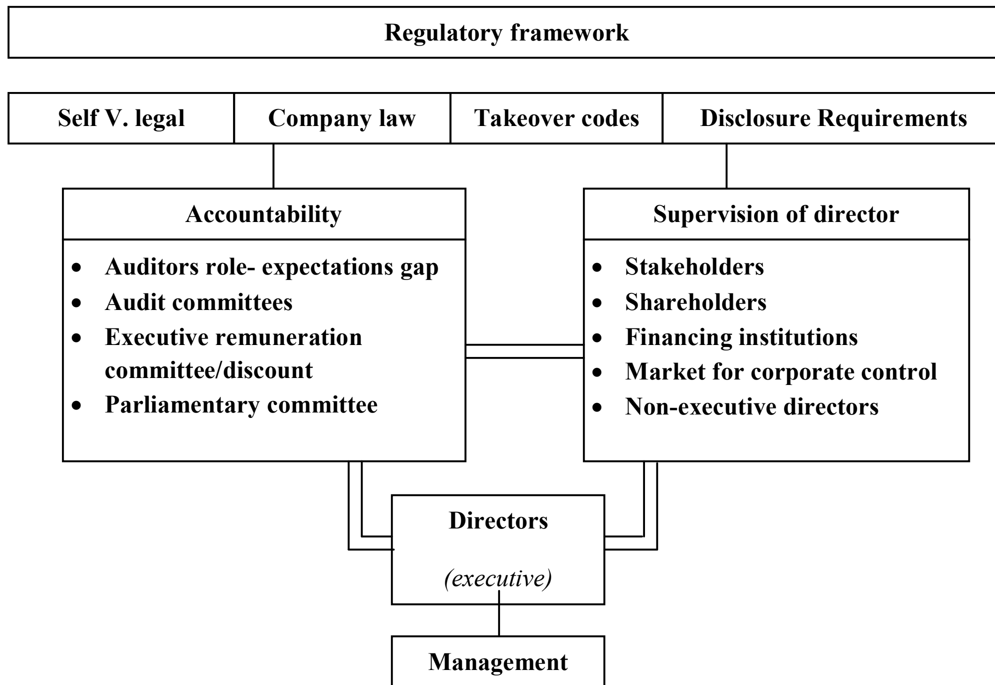


The features of the Japanese model are:

- Inclusion of president who consults both the supervisory board and the executive management.
- Importance of lending banks is highlighted.
- Capital markets are not quite as active.
- Long-term goals are pursued in preference to short-term goals.
- Board of Directors carries out the management functions.
- Sometimes the Financial Institutions monitor the management functions by nominating the managerial personnel.

The Indian Model

The Indian model of corporate governance is a mix of the Anglo American and German models. Corporations in India can be grouped into three categories: private companies, public companies, banks and other corporations.



The features of the Indian Model are as follows:

- The government owned the equity shares wholly or substantially (51% or more).
- Good deal of political and bureaucratic influence over the management.
- Excessive emphasis on observing rules, regulations and guidelines.
- Efficiency and performance are sacrificed at the altar of proprietary.
- Organisation often viewed as social entity.
- Administrative ministry appoints the board of directors.

1.11 Let's Sum-up

Corporate governance in the changing business environment has emerged as powerful tool of competitiveness and sustainability. It is very important at this point and it needs corporation for one and all i.e. from CEO of company to the ordinary staff for the maximization of the stakeholders' value and also for maximization of pleasure and minimization of pain for the long term business.

Global competitions in the market need best planning, management, innovative ideas, compliance with laws, good relation between directors, shareholders, employees and customers of companies, value based corporate governance in order to grow, prosper and compete in international markets by strengthen their strength overcoming their weaknesses and running them effectively and efficiently in an efficient and transparent manner by adopting the best practices.

Corporate India must commit itself as reliable, innovative and prompt service provider to their customers and should also become reliable business partners in order to prosper and to have all round growth.

Corporate Governance is nothing more than a set of ideas, innovation, creativity, thinking having certain ethics, values, principles etc. which gives direction and shape to its people, employees and owners of companies and help them to flourish in global market.

1.12 Key Terms

Corporate Governance: Corporate Governance refers to the way a corporation is governed. It is the technique by which companies are directed and managed.
Stakeholder:A stakeholder is a party that has an interest in a company, and can either affect or be affected by the business.

Board of Directors:A board of directors is a "committee elected by the shareholders of a limited company to be responsible for the policy of the company.

Transparency: Transparency means openness, a willingness by the company to provide clear information to shareholders and other stakeholders.

Responsibility: It refers to the entrustment of duties and responsibilities on the part of the Board of Directors.

Accountability: Accountability refers to the obligation and responsibility to give an explanation or reason for the company's actions and conduct.

1.13 Self-Assessment Questions

1. Define corporate governance. Highlight the principles of good corporate governance.

Ans. ____

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2. State all the objectives of corporate governance.

Ans. ____

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3. Mention the features of Japanese model of corporate governance.

Ans. ____

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1.14 Further Readings

1. H.R. Machiraju, Corporate Governance, Himalaya Publishing House.
2. A.C. Fernando, Corporate Governance *Principles, Polies and Practices,* Pearson.
3.Corporate Governance, *Francis Cherunilam,* Himalaya Publishing House, Mumbai.
4.Corporate Governance: Principles, Mechanisms & Practice, *Swami Parthasarathy*, Biztantra, New Delhi.
5. Conceptual Framework of Corporate Governance, *Sharma, PriyankaKaushik*, Macmillan Publishers India Ltd., Noida, U.P.

1.15 Model Questions

1. Define corporate governance. State the objectives and importance of corporate governance.
2. What are the main issues on which the corporate governance focuses?
3. Briefly explain the evolution of corporate governance in India.
4. Explain the Indian model of corporate governance in details. And explain how it is different from other models of corporate governance.

Unit-II
Committees on Corporate Governance

Learning Objectives

After completion of the unit, you should be able to:

- Understand the committee approach to Corporate Governance.
- Appreciate the SEBI guidelines to Corporate Governance.
- Know the views of Kumar Mangalam Birla Committee on Corporate Governance.
- Know the views of Cadbury Committee on Corporate Governance.
- Appreciate the views of various Committees on Corporate Governance.

Structure

2.1 Introduction
2.2 Committee approach to Corporate Governance
2.3 SEBI guidelines to Corporate Governance
2.4 Kumar Mangalam Birla Committee on Corporate Governance
2.5 Cadbury Committee on Corporate Governance
2.6 Views of other Committees on Corporate Governance
2.7 Corporate Governance: Recent Development in India
2.8 Let's Sum-up
2.9 Key Terms
2.10 Self Assessment Questions
2.11 Further Readings
2.12 Model Questions

2.1 Introduction

The emergence of corporate governance as a fair and transparent mechanism to run and administer corporations which would result in long-term shareholder value and benefits to the entire society has been a recent phenomenon. The witnessing of corporate scams and frauds has brought a vast change in people's minds as to the objectives of a corporation that is not only giving importance to the owners but also to the various stakeholders who have an important bearing on the workings of the company. The investing public expects corporation in which they invest to adopt better governance practices, code and conducts to bring out fairness and transparency in their dealings.

Corporate governance gained importance after the Watergate scandal in the US. Investigations highlighted control failures that had allowed several major corporations and to bride government officials. This led to the development of the Foreign and

Corrupt Practices Act of 1977. This was followed in 1979 by the Securities and Exchange Commission's proposals for mandatory reporting on internal financial controls. In England, the seeds of modern corporate governance were sown by the BCCI scandal. Another landmark that heightened people's awareness and sensitivity on the issue was the failure of Baring Bank. These are just a couple of examples of corporate failure due to absence of a proper structure and objectives in the top management that affect the shareholders and other interested parties. Companies such as Polly Peck, British & Commonwealth and Robert Maxwell's Mirror Group News International were all victims of corporate failures out of poorly managed business practices. This resulted into the formation of Combined Code on Corporate Governance (The Hampel Report) in 1998 in United Kingdom.

The developments in UK had tremendous influence on India. Corporate failures and the reports of various committees starting with Cadburys had a great impact on Indian corporate sectors. They triggered the thinking process in the country, which finally led to the government and regulators laying down the ground rules on corporate governance. The government accordingly set up a Working Group on the Companies Act in August 1996 for this purpose.

2.2 Committee approach to Corporate Governance

There were several frauds and scams in the corporate history of the world. It was felt that the system for regulation is not satisfactory and it was felt that it needed substantial external regulations. These regulations should penalize the wrong doers while those who abide by rules and regulations, should be rewarded by the market forces. There were several changes brought out by governments, shareholder activism, insistence of mutual funds and large institutional investors, that corporate they invested in adopt better governance practices and in formation of several committees to study the issues in depth and make recommendations, codes and guidelines on Corporate Governance that are to be put in practice. All these measures have brought about a metamorphosis in corporate that realized that investors and society are serious about corporate governance. The main committees, known by the names of the individuals who chaired them are discussed hereunder

a) Cadbury committee on Corporate Governance – 1992

The stated objectives of the Cadbury Committee is "To help raise the standards of corporate governance and the level of confidence in financial reporting and auditing by setting out clearly what it sees as the respective responsibilities of those involved and what it believes his expected of them.

The committee investigated the accountability of the board of directors to shareholders and to society. It submitted its report and associated "Code of Best Practices" in 1992 wherein it spelt out the methods of governance needed to achieve a balance between the essential power of the board of directors and their proper accountability. Its recommendations were not mandatory. The Cadbury code of best practices had 19

recommendations. The recommendations are in the nature of guidelines relating to the board of directors, non-executive directors, executive directors and those on reporting and control. The stress in the Cadbury committee report is on the crucial role of the board and the need for it to observe the Code of Best Practices. It's important recommendations include the setting up of an audit committee with independent members.

b) The Paul Ruthman Committee

The committee was constituted later to deal with the said controversial point of Cadbury Report. It watered down the proposal on the grounds of practicality. It restricted the reporting requirement to internal financial controls only as against "the effectiveness of the company's system of internal control" as stipulated by the Code of Best Practices contained in the Cadbury Report. The final report submitted by the Committee chaired by Ron Hampel had some important and progressive elements, notably the extension of directors' responsibilities to "all relevant control objectives including business risk assessment and minimizing the risk of fraud…."

c) The Greenbury Committee

This committee was setup in January 1995 to identify good practices by the Confederation of British Industry (CBI), in determining directors' remuneration and to prepare a code of such practices for use by public limited companies of United Kingdom. The committee aimed to provide an answer to the general concerns about the accountability by the proper allocation of responsibility for determining directors' remuneration, the proper reporting to shareholders and greater transparency in the process. The committee produced the Greenbury Code of Best Practice which was divided into the four sections: Remuneration Committee, Disclosures, Remuneration Policy and Service Contracts and Compensation.

The Greenbury committee recommended that UK companies should implement the code as set out to the fullest extent practicable, that they should make annual compliance statements, and that investor institutions should use their power to ensure that the best practice is followed.

d) The Hampel Committee

The Hampel committee was setup in November 1995 to promote high standards on Corporate Governance both to protect investors and preserve and enhance the standing of companies listed on the London Stock Exchange. The committee developed further the Cadbury report. And it made the following recommendations.

i) The auditors should report on internal control privately to the directors.

ii) The directors maintain and review all controls.

iii) Companies should time to time review their need for internal audit function and control.

It also introduced the combined code that consolidated the recommendation of earlier corporate governance reports (Cadbury Committee and Greenbury Committee).

e) The Combined Code

The combined code was subsequently derived from Ron Hampel Committee's Final Report, Cadbury Report and the Greenbury Report. The combined code is appended to the listing rules of the London Stock Exchange. As such, compliance of the code is mandatory for all listed companies in UK.

The stipulations contained in the Combined Code require, among other things, that the boards should maintain a sound system of internal control to safeguard shareholder's investments and the company's assets. The directors should, at least annually, conduct a review of the effectiveness of the group's system of internal control covering all controls, including financial, operational and compliance and risk management, and report to shareholders that they have done so.

f) The Turnbull Committee

The Turnbull Committee was set up by the Institute of Chartered Accountants in England and Wales (ICAEW) in 1999 to provide guidance to assist companies in implementing the requirements of the Combined Code relating to internal control. The committee provided guidance to assist companies in implementing the requirements of the Combined Code relating to internal control. It recommended that where companies do not have an internal audit function, the board should consider the need for carrying out an internal audit annually. The committee also recommended that board of directors confirm the existence of procedures for evaluation and managing key risks. Corporate Governance is constantly evolving to reflect the current corporate economic and legal environment. To be effective, corporate governance practices need to be tailor to particular needs, objectives and risk management structure of an organization.

g) World Bank on Corporate Governance

The World Bank, involved in sustainable development was one of the earliest economic organization to study the issue of corporate governance and suggest certain guidelines. The World Bank report on corporate governance recognizes the complexity of the concept and focuses on the principles such as transparency, accountability, fairness and responsibility that are universal in their applications.

Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible, the interests of individuals, organizations and society. The foundation of any corporate governance is disclosure. Openness is the basis of public confidence in the corporate system and funds will flow to those centers of economic activity, which inspire trust. This report points the way to establishment of trust and the encouragement of enterprise.

It marks an important milestone in the development of corporate governance. There are some important committees discussed in details under the following topics.

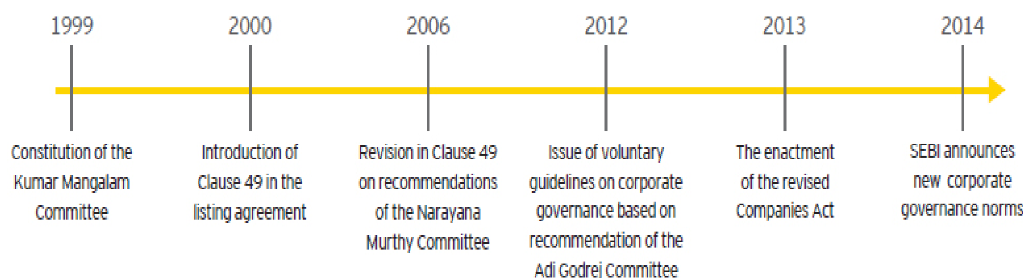
2.3 SEBI Guidelines to Corporate Governance

In India also, various initiatives have been taken in the past by the Ministry of Corporate Affairs and SEBI to ascertain that those entrusted with the responsibility of governing shareholder wealth are adequately regulated and made accountable. Over the past 15 years, there have been many reforms in the corporate governance framework - starting from constitution of the Kumar Mangalam Committee (1999), introduction of Clause 49 in the listing agreement (2000), revision in Clause 49 on recommendations of the Narayana Murthy Committee (2006), issue of voluntary guidelines on corporate governance (2009), issue of guiding principles on corporate governance (2012) based on recommendation of the Adi Godrej Committee, enactment of the revised Companies Act (2013) and finally the new corporate governance norms by SEBI (2014).

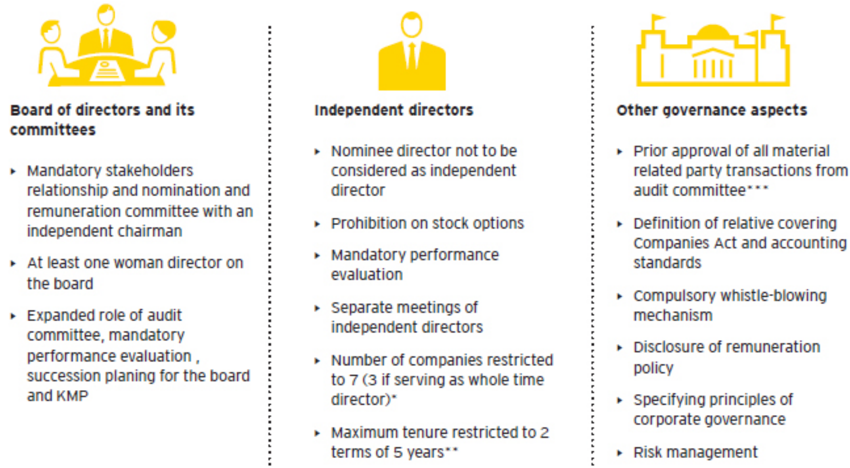
Although, the Companies Act 2013 specifies the minimum requirements of governance applicable to all companies, a recent press release by SEBI indicates a move towards aligning the requirement for listed companies with that of the Companies Act and simultaneously raises the bar on governance standards for listed companies.

The regulator has clearly indicated a move towards increased transparency on conducting Board Matters and articulated several changes in the roles and responsibilities of the board, board committees and independent directors. This move also indicates the intent of the regulators to align with the global standards on corporate governance adopted in mature economies (such as the UK Companies Act, US MBCA, US-DGCL, UK FRC Code, Stewardship Code and SOX). The board of directors is a vital link between shareholders and management, and hence has a very critical role and responsibility in the overall governance framework. The recent press release by SEBI confirms this aspect, wherein the responsibilities of the board, its committees and independent directors have been the primary focus.

Corporate governance: key milestones



Key changes proposed by SEBI



The need to comply with the Companies Act has proved challenging for several companies and with the introduction of the revision in governance requirements by SEBI, the compliance is likely to become more onerous for listed companies with a consequent effect on the cost of compliance.

Notwithstanding the implications and challenges, organizations need to leverage this development as an opportunity to strengthen the governance framework and deliver incremental gains through enhanced investor confidence.

In 2014, SEBI came out with detailed corporate governance norms for listed companies providing for stricter disclosures and protection of investor rights, including equitable treatment for minority and foreign shareholders.

- The new rules require companies to get shareholders' approval for related party transactions, establish whistle blower mechanism, elaborate disclosures on pay packages and have at least a woman director on their boards. SEBI's norms issued are aligned with the new Companies Act and is aimed to encourage companies to "adopt best practices on corporate governance".
- The capital market regulator has amended clauses 35B and 49 of the listing agreement. Now, under changed 35B norms, listed companies are required to provide the option of facility of e-voting to shareholders on all resolutions proposed to be passed at general meetings. Under clause 49, pertaining to corporate governance, listed entities have to get shareholders' nod for related party transactions.
- Besides the market watchdog has come out with norms to ensure "equitable treatment of all shareholders including minority and foreign shareholders".
- Apart from providing adequate and timely information to all shareholders, listed companies should also facilitate the exercise of voting rights by foreign shareholders.

- The company should devise an effective whistle blower mechanism enabling stakeholders, including individual employees and their representative bodies, to freely communicate their concerns about illegal or unethical practices.
- There would be expanded role of audit committee and enhanced disclosure of remuneration policies.
- Separate meetings of independent directors, and constitution of 'stakeholders' relationship committee' are also a part of the proposals.
- The watchdog has decided that the maximum number of boards an independent director can serve on listed companies be restricted to 7, while the directorship would be capped at three if the person is serving as a whole time director in any listed company.
- The board of Securities and Exchange Board of India (SEBI) had approved the new set of norms during its meeting.

2.4 Kumar Mangalam Birla Committee on Corporate Governance

Kumar Mangalam Birla headed the committee appointed by, the Securities and Exchange of India (SEBI), on May 7, 1999. The committee was formed to promote and raise the standards of corporate governance.

The objective of this committee was to:

(a) Suggest suitable amendments to the listing agreement with the companies executed by the stock exchanges.

(b) To suggest measures to improve the standards of corporate governance in the listed companies, in areas such as continuous disclosures of material information, both financial and non-financial, manner and frequency of such disclosures, responsibilities of independent and outside directors.

(c) Draft a code of corporate best practices; and

(d) Suggest safeguards to be instituted within the companies to deal with insider information and insider trading.

Some of the recommendations made by Kumar Mangalam Birla Committee are as follows:

1. They should have an optimum combination of executive and non-executive directors and at least 50% of the board should comprise of non-executive directors. Further, at least one-third of the board should comprise of independent directors where the chairman is non-executive and at least half of the board should be independent in case of an executive chairman.
2. A qualified and an independent “audit committee” should be set up by the board of the company.

3. The board should set up a “remuneration committee” to determine on their behalf and on the behalf of the shareholders with agreed terms of references, the company’s policy on specific remuneration packages for executive directors including pension rights and any compensation payment.
4. The board should set up a committee under the chairmanship of a non-executive/independent director to specifically look into shareholder issues including share transfer and redressing of shareholder complaints.
5. To expedite the process of share transfers, the board should delegate the power to an officer or a committee or the registrar.
6. Annual report should make disclosures on remuneration paid to directors in all forms including salary, benefits, bonuses, stock options, pension and other fixed as well as performance linked incentives paid to the directors.
7. The board meetings should be held four times in a year, with maximum gap of four months between two meetings.
8. Management discussion and analysis report should form part of the annual report to the shareholders.
9. All company related information like quarterly results, presentation made by companies to analysts should be put on company’s website as well as on the website of the stock exchange on which the company is listed.
10. Non-compliance of any mandatory recommendations with reasons and the extent to which the non-mandatory recommendations have been adopted should be specifically highlighted.
11. No director should be a member in more than 10 committees or act as chairman of more than five committees across all companies in which he is a director.
12. The company should provide a brief resume, expertise in specific functional areas and name of companies, in which the person holds the directorship and the membership of committees of the board, while appointing a new director or re-appointing an existing director.
13. Disclosures to be made to the board by the management relating to all material, financial and commercial transactions, where they have personal interest that may have a potential conflict with the interest of the large which includes dealings in company shares, commercial dealing with bodies, which have shareholding of management and their relatives, etc.
14. The half yearly declaration of financial performance including summary of the significant events in the last six months, should be sent to each household of shareholders.
15. The term lending financial institutions to have nominees on the boards of the borrowing companies, to protect their interests as creditors. In such cases the nominee directors should take an active interest in the activities of the board.

16. A separate section on compliance with the mandatory recommendations of clause 49 should form part of the report and details of non-compliance should be highlighted.
17. A certificate from the auditors on compliance should form part of the annual report and annual return and a copy has to be sent to the stock exchanges.

2.5 Cadbury Committee on Corporate Governance

The stated objective of the Cadbury Committee was “to help raise the standards of corporate governance and the level of confidence in financial reporting responsibilities of those involved and what it believes is expected of them.” The Cadbury Code of Best Practices has 19 recommendations. The recommendations are in the nature of guidelines relating to the board of directors, non-executive directors, executive directors and those on reporting and control.

Relating to the **board of directors**, the recommendations are as follows:

1. The board should meet regularly, retain full and effective control over the company and monitor the executive management.
2. There should be a clearly accepted division of responsibilities at the head of a company, which will ensure balance of power and authority, such that no individual has unfettered powers of decision.
3. The board should include non-executive directors of sufficient calibre and number, for their views to carry significant weight in the board’s decision.
4. The board should have a formal schedule of matters specifically reserved to it for decisions to ensure that the direction and control of the company is firmly in its hands.
5. There should be an agreed procedure for directions in the furtherance of their duties to take independent professional advice, if necessary, at the company’s expense.
6. All directors should have access to the advice and services of the company secretary, who is responsible to the board for ensuring that board procedures are followed.

Relating to the **non-executive directors**, the recommendations are:

7. Non-executive directors should have independent judgement relating to the issues of strategy, performance, resources, including key appointments and standards of control.
8. The majority should be independent of the management and free from any business or other relationships, which could materially interfere with the exercise of their independent judgement, apart from their fees and shareholdings.
9. Non-executive directors should be appointed for a specified terms and their reappointments should not be automatic.

10. They should be selected through a formal process and this process and their appointment should be a matter for the Board as a whole.

For the **executive directors**, recommendations are:

11. Directors' service contracts should not exceed 3 years without shareholders' approval.
12. There should be full and clear disclosure of their total emoluments and those of the chairman, including pension contributions, stock options, separate figures for salary and performance related elements.
13. Executive directors' pay should be subject to the recommendations of a remuneration committee made up wholly or mainly of non-executive directors.

On **reporting and controls**, the report stipulates the followings:

14. Boards' duty to present a balanced and understandable assessment of the company's position.
15. Board should ensure objective and professional relationship with the auditors.
16. Board should establish an audit committee at least three non-executive directors clearly stating its authority and duties.
17. Directors should explain their responsibility for preparing accounts next to a statement by the Auditors about their reporting responsibilities.
18. Directors should report on the effectiveness of the company's system of internal control.
19. Director should report that the business is going concern, with supporting assumptions or qualifications, as necessary.

The recommendations made by the Cadbury committee were widely accepted by corporate in the UK and they became a reference point for many other committees, which were set up by various governments all over the world.

2.6 Views of Other Committees on Corporate Governance

OECD REPORT

Organization for Economic Co-operation and Development (OECD) was one of the earliest non-governmental organizations to work on and spell out principles and practices that should govern corporate in their goal to attain long-term shareholder value.

The OECD was trend setters as the Code of Best practices are associated with Cadbury report. The OECD principles in summary include the following elements.

i) The rights of shareholders

ii) Equitable treatment of shareholders

iii) Role of stakeholders in corporate governance

iv) Disclosure and Transparency

v) Responsibilities of the board

The OECD guidelines are somewhat general and both the Anglo-American system and Continental European (or German) system would be quite consistent with it.

Confederation of Indian Industry (CII) Report

The Confederation of Indian Industry (CII) is a non-profit, non-government, industry-led and industry-managed organization, seeking to play a proactive role in India's development process. The organization works to create and sustain an environment conducive to the growth of industry in India, partnering industry and government alike through advisory and consultative processes. The Confederation is headquartered in New Delhi.

CII took the initiative to draft some codes of corporate governance. A national task force on corporate governance was set up in mid-1996 under the leadership of Mr. Rahul Bajaj, ex-president, CII and CMD, Bajaj Auto Ltd.

Objectives of CII:

The primary goal of CII is to develop Indian Industry and to ensure that government and society as a whole, understand both the needs of industry and its contribution to the nation's wellbeing. The objectives of CII are as follows:

i) To identify and strengthen India's role in the economic development of the country.
ii) To act as a catalyst in bringing about the growth and development of Indian Industry.
iii) To reinforce industry's commitment to society.
iv) To provide up-to-date information and data to industry and government.
v) To create awareness and support industry's effort on quality, environment, energy management and consumer protection.
vi) To identify and address the special needs of the small sector to make it more competitive.
vii) To work towards the globalization of Indian Industry and integration into the world economy.

Some of the Recommendations made by CII Committee on Corporate Governance are given below: -

i) The board should meet a minimum of six times a year, preferably at an interval of two months, and each meeting should have agenda items that require at least half a day's discussion.
ii) Any listed company with a turnover of Rs 100 crores and higher should have professionally competent, independent, non-executive directors, who should constitute at least 30% of the board if the chairman of the company is a non-executive director or at least 50% of the board if the chairman and managing director is the same person.

iii) No single person should directorship in more than 10 companies. This ceiling excludes directorship in subsidiaries (where the group has over 25% but no more than 50% equity stake).

iv) For non-executive directors to play a material role in corporate decision making and maximizing long term shareholders value, they need to become active participants on the board, not passive advisors; have clearly defined responsibilities within the board such as audit committee; and know how to read a Balance Sheet, P/L account, Cash Flow Statements, and Financial Ratios and have some knowledge of various Company Laws. This of course, excludes those who are invited to join boards as experts in other fields such as science and technology.

v) To secure better effort from non-executive directors, companies should pay a commission over and above the sitting fees for the use of professional inputs.

vi) While re-appointing members of the board, companies should give the attendance record of the concerned directors. As a general practice, one should not re-appoint any director who has not had the time to attend even one half of the meetings.

vii) Key information that must be reported and placed before the board must include:

- Annual operating plans and budgets.
- Capital budgets
- Quarterly results
- Internal audit reports including cases of theft and dishonesty of any material nature
- Defaults in payments
- Defaults in non-payment of such as inter-corporate deposits, etc.
- Details of joint venture or collaboration agreement.
- Transactions involving substantial payment towards Goodwill, Brand Equity or Intellectual Property.
- Recruitment and remuneration of executives
- Labour problems and their proposed solutions

Narayana Murthy Committee Report

The concept the corporate governance has been evolving and the same has grown over the years. With a view to further improving the standards of Corporate Governance in India, SEBI constituted a Committee under the Chairmanship of Shri N. R. Narayana Murthy, Chairman and Chief Mentor of Infosys Technologies Limited. The Committee included representatives from Chambers of Commerce as well as leading professional bodies.

(A) Terms of Reference:

The terms of reference of the Committee were twofold:

(i) To review the performance of Corporate Governance

(ii) To determine the role of companies in responding to rumors and other price sensitive information circulating in the market in order to enhance the transparency and integrity of the market.

(B) Recommendation:

(i) The audit committees of public listed companies should be required to review the following information mandatorily among others- (a) financial statements, (b) management discussion and analysis of financial condition and (c) results of operations,(d) reports relating to compliance with laws and (e) risk management.

(ii) All audit committee members should be "financially literate" and at least one member should have accounting or related financial management expertise.

(iii) In case a company has followed a treatment different from that prescribed in an accounting standard, management should justify why they belief such alternative treatment is more representative of the underlying business transaction. It should also provide a footnote for such changes in the financial statements.

(iv) A statement of all transactions with related parties including their bases should be placed before the independent audit committee at each board meeting for formal approval.

(v) The committee believes that it is important for corporate boards to be fully aware of the risks facing the business and it is important for the shareholders to know about the process by which companies manage their business risks. In light of this, suggestions regarding risk assessment and minimization procedures to be informed to the board members. There should be periodical review of such procedures.

(vi) It was also suggested that management should place of report before the board every quarter documenting any limitations to the risk taking capacity of the corporation, measures to address and minimize risks. This document should be formally approved by the board.

(vii)Companies should encourage to train their board members in the business model of the company as well as the risk profile of the business parameters of the company.

(viii) Companies raising money through an IPO i.e. Initial Public Offer should disclose the uses and applications of funds on quarterly basis as a part of quarterly declaration of unaudited financial results.

(ix) On an annual basis, the company shall prepare a Statement of Funds utilized for purposes other than those stated in the offer document/prospectus.

This statement should be certified by the independent auditors of the company and formally approved by the audit committee.

Naresh Chandra Committee Report on Corporate Governance

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 as improved. The committee stingily 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 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 on replacing an auditor as 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 to 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 showed 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 treats 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.

2.7 Corporate Governance: Recent Developments in India

It is observed that the scale and scope of economic reform and development in India over the past 20 years has been impressive. The country has opened up large parts of its economy and capital markets, and in the process has produced many highly regarded companies in sectors such as information technology, banking, autos, steel and textile manufacturing. These companies are now making their presence felt outside India through global mergers and acquisitions.

As mentioned above, a lesser known fact remains about India is that in April 1998 the country produced one of the first substantial codes of best practice in corporate governance in Asia. It was published not by a governmental body, a securities regulator or a stock exchange, but by the Confederation of Indian Industries (CII), the country's peak industry body.

The following year, the government appointed a committee under the leadership of

Kumar Mangalam Birla, Chairman, Aditya Birla Group, to draft India's first national code on corporate governance for listed companies. Many of the committee's recommendations were mandatory, closely aligned to international best practice at the time and set higher governance standards for listed companies than most other jurisdictions in Asia. The Indian Code of Corporate Governance, approved by the Securities and Exchange Board of India (SEBI) in early 2000, was implemented in stages over the following two years and led to changes in stock exchange listing rules, notably the new Clause 49 in the Listing Agreement.

Further reforms have been made over the past decade to modernise both company law and securities regulations. The Companies Act, 1956 has been amended several times, in areas such as postal ballots and audit committees, while committees were appointed in 2002 and 2004 to recommend improvements. The latter committee, chaired by Dr J.J Irani, was charged with undertaking a comprehensive review of the 1956 Act and its recommendations led to a rewrite of the law and a new Companies Bill, 2008.

In the area of securities regulation, SEBI has made numerous changes in recent years including: revising and strengthening Clause 49 in relation to independent directors and audit committees; revising Clause 41 of the Listing Agreement on interim and annual financial results; and amending other listing rules to protect the interests of minority shareholders, for example in mergers and acquisitions.

Not surprisingly, the recent Satyam fraud of late 2008 led to renewed reform efforts by Indian authorities and regulators. SEBI brought out new rules in February 2009 requiring greater disclosure by promoters (i.e., controlling shareholders) of their shareholdings and any pledging of shares to third parties. And in November 2009 it announced it would be making some further changes to the Listing Agreement, including requiring listed companies to produce half yearly balance sheets. Confederation of Indian Industry (CII) Taskforce on CorporateGovernance

History tells us that even the best standards cannot prevent instances of major corporate misconduct. This has been true in the US - Enron, WorldCom, Tyco and, more recently gross miss-selling of collateralized debt obligations; in the UK; in France; in Germany; in Italy; in Japan; in South Korea; and many other OECD nations. The Satyam-Maytas Infra-Maytas Properties scandal that has rocked India since 16th December 2008 is another example of a massive fraud.

Satyam is a one-off incident - especially considering the size of the malfeasance. The overwhelming majority of corporate India is well run, well regulated and does business in a sound and legal manner. However, the Satyam episode has prompted a relook at our corporate governance norms and how industry can go a step further through some voluntary measures.

With this in mind, the CII set up a Task Force under Mr.Naresh Chandra in February

2009 to recommend ways of further improving corporate governance standards and practices both in letter and spirit.

The recommendations of the Naresh Chandra Task Force evolved over a series of meetings. The leitmotif of the report is to enunciate additional principles that can improve corporate governance in spirit and in practice. The report enumerates a set of voluntary recommendations with an objective to establish higher standards of probity and corporate governance in the country.

The recommendations outlined in this report are aimed at listed companies and wholly owned subsidiaries of listed companies.

The recommendations in brief are as under:

1. Appointment of Independent Director
    a. Nomination Committee
2. Duties, liabilities and remuneration of independent directors
    a. Letter of Appointment to Directors
    b. Fixed Contractual Remuneration
    c. Structure of Compensation to NEDs
3. Remuneration Committee of Board
4. Audit Committee of Board
5. Separation of the offices of the Chairman and the Chief Executive Officer
6. Attending Board and Committee Meetings through Tele-conferencing and video conferencing
7. Executive Sessions of Independent Director
8. Role of board in shareholders and related party transactions
9. Auditor – Company Relationship
10. Independence to Auditors
11. Certificate of Independence
12. Auditor Partner Rotation
13. Auditor Liability
14. Appointment of Auditors
15. Qualifications of Auditors Report
16. Whistle Blowing Policy
17. Risk Management Framework
18. The legal and regulatory standards
19. Capability of Regulatory Agencies - Ensuring Quality in Audit Process
20. Effective and Credible Enforcement
21. Confiscation of Shares
22. Personal Liability
23. Liability of Directors and Employees
24. Institutional Activism
25. Media as a stakeholder

According to the report, much of best-in-class corporate governance is voluntary – of companies taking conscious decisions of going beyond the mere letter of law. The spirit of this Task Force Report is to encourage better practices through voluntary adoption - based on a firm conviction that good corporate governance not only comes from within but also generates significantly greater reputational and stakeholder value when perceived to go beyond the rubric of law.

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.

The guidelines are divided into the following six parts:

i) Board of Directors
ii) Responsibilities of the Board
iii) Audit Committee of the Board
iv) Auditors
v) Secretarial Audit
vi) 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.

2.8 Let's Sum-Up

As we know and understand there were several frauds and scams in the corporate history of the world. It was felt that the system for regulation is not satisfactory and it was felt that it needed substantial external regulations. These regulations should penalize the wrong doers while those who abide by rules and regulations, should be rewarded by the market forces. There were several changes brought out by governments, shareholder activism, insistence of mutual funds and large institutional investors, that corporate they invested in adopt better governance practices and in formation of several committees to study the issues in depth and make recommendations, codes and guidelines on Corporate Governance that are to be put in practice.

Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible, the interests of individuals, organizations and society. The foundation of any corporate governance is disclosure. Openness is the basis of public confidence in the corporate system and funds will flow to those centers of economic activity, which inspire trust. This report points the way to establishment of trust and the encouragement of enterprise. It marks an important milestone in the development of corporate governance.

2.9 Key Words

- Guidelines
- Mandatory recommendations
- Non-mandatory recommendations
- SEBI initiatives

2.10 Self Assessment Questions

1. Mention some of the OECD principles of Corporate Governance.

Ans. ____

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2. Briefly mention some of the recommendations by Cadbury Committee on Corporate Governance.

Ans. ____

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2.11 Further Readings

1. Corporate Governance, *H.R. Machiraju*, Himalaya Publishing House, Mumbai.
2. Corporate Governance: Principles, Polies and Practices,*A.C. Fernando*, *Pearson*.
3. Corporate Governance, Francis Cherunilam, Himalaya Publishing House, Mumbai.
4. Corporate Governance: Principles, Mechanisms & Practice, *Swami Parthasarathy*, Biztantra, New Delhi.
5. Conceptual Framework of Corporate Governance, *Sharma, PriyankaKaushik*, Macmillan Publishers India Ltd., Noida, U.P.

2.12 Model Questions

1. Describe the recommendations of SEBI on Corporate governance.
2. Discuss the recommendations made by Cadbury Committee.
3. Describe the recommendations of Kumar Mangalam Committee report on Corporate Governance.