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Philosophy of CG

The Cadbury Report was the beginning of Corporate Governance in the Developed countries,

In India, it was Mahatma Gandhi who captured the essence of the concept as

“The end does not justify the means.”



Factors for

The Emergence of CG in India

- Corporate Scandals
 - The stock market scandal (Harshad Mehta) in 1992.
 - Ketan Parekh scandal in 2001
 - Tata Finance scandal (Serious financial irregularities in the amount of rupees 400crores (86.95 million dollars) were detected)
 - Accounting and financial reporting frauds
 - Vanishing companies scam
- In order for the Indian capital market and Indian companies to compete in the global market, India needs a set of good corporate governance doctrines



Requirements for CG

- Corporate governance in India calls for
Two main requirements:
Transparency in decision-making, and
Accountability
to ensure that
responsibility could be assigned easily
for actions or inaction and
also for the safeguarding the interests of the
stakeholders and the investors in the
organization.



Corporate Governance

- Corporate Governance as
 - the efficient supervision which encourages 'doing everything better' and
 - protects the interest of the company
 - while conforming to all established laws and ethics.
- Corporate governance in any organisation needs to be principle based and
- SMART- smart, moral, accountable, responsive and transparent.
- Corporate governance has to be principle-based not rule-based.



Regulators for CG

- Indian Companies Act, 1956
- SEBI Act, 1992
- Stock Exchanges-Listing Agreement
- ICAI Act, 1949
- ICSI
- ICWAI



Journey of CG in India

- **Voluntary-industry driven**
- The corporate governance movement in India began in 1997 with a voluntary code framed by the CII : Desirable Corporate Governance: A Code
 - In the next three years, almost 30 large listed companies accounting for over 25 per cent of India's market capitalisation voluntarily adopted the CII code



Journey of CG in India

- **Several committees on Corporate Governance**
- Kumar Mangalam Birla Committee report
 - the introduction of Clause 49 in the standard Listing Agreement in 2000,
 - All listed companies are mandatorily required to comply with the clause
- the Naresh Chandra Committee,
- Narayana Murthy Committee
- J.J. Irani are Committee



The Companies (Amendment) Bill of 2003

- Introduced and passed by the upper house of the Indian parliament
- Incorporated some recommendations based on the Naresh Chandra Committee report
- Returned to the Department of Company Affairs for redrafting

Comprehensive law governing Corporate Governance

- **Clause 49** is not the only legislation on governance.
- **The Companies Act, 1956** itself covers corporate governance widely through its various provisions such as
 - inclusion of directors' responsibility statement in the directors' report under Section 217(2AA),
 - constitution of audit committee under Section 292A,
 - fixing maximum ceiling on remuneration that can be drawn by a director under Schedule XIII,
 - Relating to oppression, mismanagement, etc.
- Further, **environmental and other pieces of legislation** also protect different stakeholders' interest, ensuring, in the process, good corporate governance.



The key aspects of CG

- **Composition of the board** with optimum number of independent directors
- **Constitution of audit committee** with the chairman being an independent director,
- Laying down **a code of conduct** for board members,
- **Mandatory disclosures** on related party transactions,
- **Risk management,**
- **Certification** on financial statements and internal controls by the CFO (chief financial officer),
- **Mandatory reporting** on corporate governance along with annual report, etc.



Recent Developments: Clause 49

- Corporates have been advised to comply with the **Revised guidelines on corporate governance** as per the recommendations of the Narayana Murthy Committee
- Initially, the compliance date was April 1, 2005 which was subsequently extended to December 31, 2005.
- Certain provisions of Clause 49 were clarified in January 2006.
 - a) maximum gap between two board meetings has been increased to four months;
 - b) sitting fees paid to the non-executive directors would not require prior approval of the shareholders;
 - c) certification of internal controls and internal control systems by CEO /CFO would be for the purpose of financial reporting.



Compliance :Clause 49

- The actual implementation of corporate governance has so far been **sparse and poor**
- Recent media reports suggest that though a year has gone by, some 60% of Indian firms have not yet complied with Clause
- Influence of business houses on politics and on policy makers
 - The influence that the important corporate houses have on the SEBI and the Joint Parliamentary Committees
 - The enforcement regime is weak and easily swayed
 - the furor raised by various sections of the industry to the Companies (Amendment) Bill of 2003
- Rampant corruption
- Numerous unclear laws with weak authorities to enforce them
- The “multiple authorities” give rise to lack of consolidated control which in turn gives rise to corrupt practices



The ICSI Initiative

- During 2000-01, the ICSI had decided to set up a **Secretarial Standards Board (SSB)** to integrate, harmonise and standardise various secretarial practices prevalent in the corporate sector
- The SSB comprises representatives of **The Company Affairs Ministry, SEBI, ICAI, and Institute of Cost and Works Accountants of India**, besides eminent members of the profession of Company Secretaries
- The Institute has so far issued **four standards** —
 - Secretarial Standards on Meetings of Board of Directors (SS-1),
 - Secretarial Standards on General Meetings (SS-2),
 - Secretarial Standards on Dividend (SS-3), and
 - Secretarial Standards on Registers and Records (SS-4).



The ICSI Initiative

- The Secretarial standards on
 - managerial remuneration,
 - loans and investments,
 - directors,
 - related party transactions, and
 - investor servicing,

are under consideration of the SSB
- *If the secretarial standards devised by ICSI were made mandatory, it would improve the compliance of corporate governance norms by India*



C G Awards in India

- **ITC Ltd and Abhishek Industries Ltd** received the Institute of Company Secretaries of India National Award for **Excellence in Corporate Governance** 2006.
- **ITC Ltd** has won the '**Golden Peacock Award for Excellence in Corporate Governance** 2005', instituted by the Institute of Directors, New Delhi, in association with the London-based World Council for Corporate Governance and Centre for Corporate Governance.



C G Awards in India

- THE Coimbatore-based Precot Mills Ltd, in association with the Tamilnadu Centre of ABK-AOTS Dosokai, Japan, has for the first time instituted an **award for textile units excelling in management practices**
- **Good corporate governance is more an exception than a rule.** Which, perhaps, explains why the various bodies have annually been announcing a national award for excellence in corporate governance



C G Awards in India

- The ICSI has consistently refused to rank companies for corporate governance. Its award process **judges but does not rate companies** for their governance performance
- Industry bodies put off plans for rating and rewarding companies on corporate governance for now. **There has to be a large number of companies effectively engaged in corporate governance before the best can be selected**



Rating

for

corporate governance practices

Mahindra & Mahindra Ltd (M&M) has been assigned

• Governance and Value Creation Rating
(GVC) Level - 1'
rating by CRISIL

for corporate governance practices. This is the highest rating in the category.

Managements not as broad based as is thought : **Prime Database**

- An analysis of the board compositions of around 1,500 companies listed on the BSE shows that 58 individuals occupy over 10 directorship positions each in these firms, with several of them holding up to 15 directorial slots.
- holding non-independent director positions, but are not involved in the day-to-day running of these companies.
- the largest number of directorial positions occupied by a single individual is 15, with four such persons in the list of the firms surveyed.
- either chartered accountants or corporate lawyers.



Indian Realities

- Due to the **distrust in Indian auditors**, most of the multinational companies have insisted that the parent company's auditor should also audit the subsidiary companies in India, often at much higher costs
- The board of directors of a company has become a tool that can be **manipulated**;
- It is very complicated with around **9,000 listed companies** in the country, and the amount of data provided is mind-boggling. To read the huge data and take a policy decision is difficult and time consuming



Indian Realities

- The annual basic salary of Rs 4,26,000 for a company's executive director (ED) may not seem much.
- But the case of Kolkata-based **Hindustan Wires Ltd** is interesting because the company's sales, at Rs 75,000 for the year ended March 31, are just about one-sixth of the pay of the ED, Mr R.K. Gupta.



Indian Realities

- **The culture of corporate governance** has not really caught on in India except for a few companies. "For instance, Mr Anil Ambani raised the issue when he fell out with his brother, Mukesh. **He accused his brother of several corporate governance failures.** Subsequently, an arrangement was worked out between the brothers and the issues were pushed under the carpet. It is not an issue between the two of them alone, as several thousands of investors are involved,"
- Most Indian companies were **controlled by families** and "it is difficult to persuade them to change their style of functioning and adopt corporate governance norms."



Indian Realities

- Norway is 'the first country in the world' to demand gender balance within the boards of public limited companies.
- In India, Companies Amendment Bill, 2003, had spoken of public company having 'such number of women directors, as may be prescribed' in Section 252 of the Companies Act
- Another issue is the **independence of the Institute of Chartered Accountants** in disciplining its peers In India,



Indian Realities

- The Chartered Accountants Act, the Company Secretaries Act, and the Cost and Works Accountants Act provide the framework for taking disciplinary action against members. **More often than not, disciplinary action is either not taken against auditors, or there is so much delay in bringing action against the auditors, that such action becomes irrelevant**
- Sections 232 and 233 of the Indian Companies Act prescribe the penalties for any company's failure to comply with these provisions, 128 and section 233 outlines penalties for auditor's non-compliance. Unfortunately, **the penalties are so insignificant that they are unlikely to deter anyone from non-compliance.**



Indian Realities

- Audit firms in India receive **inadequate remuneration**, thus explaining why audit firms engage in non-audit work
- **Better remuneration for auditors**
- **Prohibition of non-audit services,**
- **Mandatory rotation, and**
- **Stringent penalty provisions,**
could possibly address the issue of non-independence of Indian auditors



Where India Stands-CG

India stands

Third in Asia

in terms of good corporate governance,
said

Mr Rajnikant Patel,
Managing Director and CEO,
Bombay Stock Exchange Ltd



What World Bank Says

- **Indian companies' disclosure of financial information is still poor** while pressure from Indian investors to improve corporate transparency remains **weak**. With the exception of a **handful of large businesses**, most companies **do not follow international best practice** in disclosing information to investors, despite reforms to Indian corporate governance regulations. Aside from weak enforcement, the World Bank cites a lack of interest from investors as a major reason for the failure of these laws to improve disclosure according to a report from the World Bank.



What Finance Minister P Chidambaram Says

- Pulled up India Inc for flouting corporate governance norms, saying many companies have yet to appoint independent directors and audit committees.
- If I ask CEOs what is the distance they have travelled in the corporate governance milestone of 1-10, not many of them will reply that they have crossed even 3,"

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**Institute of International Finance's report : 'India's
corporate governance better'**

- *India's corporate governance system is better than those prevalent in most emerging market economies,*
 - *but it suffered from **poor enforcement of rules and regulations***
 - *neither the stock exchanges nor SEBI had increased **staff as needed** to effectively scrutinise compliance with the revised Clause 49 of the listing agreement and other rules and regulations*



Welcome Initiatives

- Ministry of Company Affairs (MCA) and the Confederation of Indian Industry (CII) in partnership with the Institute of Company Secretaries of India (ICSI) and the Institute of Chartered Accountants of India (ICAI) has set up **The National Foundation for Corporate Governance (NFCG)**.
- A model code of conduct for board directors is on the cards



Welcome Initiatives

- CRISIL Investment and Risk Management Services has launched a **corporate risk evaluation solution** for Clause 49 compliance.
- This solution has been developed in technical collaboration with Microsoft and is called the **Corporate Risk Evaluation Framework (CORE)**.
- CORE will assist corporates in implementing the directives of Clause 49 as well as putting up an **Enterprise-wise Risk Management framework**,



Realities-Problems-Challenges

- *Section 25 of the SCRA needs to be amended so that search and arrest cannot be invoked without SEBI approval and without the nod of a magistrate having jurisdiction*
 - Any violation of the said clause is punishable under Section 23 of the SCRA (Securities Contracts (Regulation) Act, 1956), which involves imprisonment for a term which may extend **up to 10 years or fine of up to Rs 25 crore or both**
 - the offence of violation of the terms of the Listing Agreement is a **cognisable one (non-bailable)**
 - that in such offences the police officers have the authority to **arrest the accused without any warrants and also conduct searches and raids on their official and residential premises.**
 - the fear of vexatious actions by vested interests resulting in **harassment of the directors** and other officers of the company by the police.
 - A bare perusal of the provisions of SCRA and the SEBI Act gives rise to two different situations



Realities-Problems-Challenges

- Clause 49 is **applicable** to all listed companies having a paid-up capital of Rs 3 crore and above or a net worth of Rs 25 crore or more at any time in the history of the company.
- In the next few years, Indian companies will be faced with **the challenge of identifying well-qualified independent directors** to join their boards; with no major business school in the country currently incorporating corporate governance into their curricula, there will likely be an acute need for the education of independent directors.

THE NUMBER OF COMPANIES AT WORK as on 31.10.2005

Category of Companies	Govt./Non-	Public/Pr	Number of
Companies Limited by Shares	Govt.	Public	724
		Private	612
	Non-Govt.	Public	78473
		Private	628957
	SUB-TOTAL		7,08,766
Guarantee Companies	Govt.		7
	Non-Govt.		3530
Unlimited Liability Companies			497
Total			7,12,800



Realities-Problems-Challenges

- There ought to be a system of evaluating the person on the Board, considering the fact that there were people on the Board **who were serving for more than 10-12 years**. “For that length of time, even the best of men and women need to get out, breathe some fresh air, and get back in to bring a fresh set value addition,”



Suggestions

- The National Investors Foundation had suggested that SEBI creates a panel of professionals suitable for appointment as independent directors based on qualification, experience, reputation etc.
 - a large number of qualified and successful business managers, many of whom waste their knowledge and experience **after retirement**
 - the term of office can be limited to **three years** in any one 'group' with a stipulated retirement age of 65 or 70.



Suggestions

- The RBI's initiative to frame **a code of ethics and standards for banks** is laudable. Perhaps a similar initiative by industry bodies would be a step in the right direction.
- Cross-listing of stocks in exchanges across countries is setting the stage for **uniform governance code**, besides setting similar credit-rating standards.
- a separate prescription for **unlisted companies**, too, was on the anvil



Conclusions

- Good ethics and governance are **not just 'moral' or 'compliance' issues**
- In the highly competitive target-driven buyers' market, there is a tendency to compromise. 'Volume creation' takes precedence over 'value creation'. **Ethical behaviour should be part of corporate culture**
- Only when we realise that **the 'means' is more important than the 'end'**, will ethics have some value
- The conduct of CEOs and the values and ethics they stand for will ensure the long-term success of a company
- Success is a short term phenomenon and **knowledge and skills have shelf life**. The successful are the ones who manage in this shelf life to adjust knowledge and skills to the market needs
- While culture and values are the drivers for good governance, codes should be preferred coming in the forefront, and law coming in slightly afterwards
- Corporate governance is not about numbers but about the quality of people



Thank You