

DISCUSSION PAPER

**CORPORATE GOVERNANCE IN
INDIA:
THEORY AND PRACTICE**

NATIONAL FOUNDATION FOR CORPORATE GOVERNANCE

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Corporate Governance: Theory and Practice

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Introduction

India has the largest number of listed companies in the world, and the efficiency and well being of the financial markets is critical for the economy in particular and the society as a whole. It is imperative to design and implement a dynamic mechanism of corporate governance, which protects the interests of relevant stakeholders without hindering the growth of enterprises.

This paper examines the concept and theory behind corporate governance and attempts to assess the direction it may take in the next few years.

Section 1 attempts to provide a definition of the concept of corporate governance and gives both a narrow and a broad definition of the concept.

Section 2 examines the question: Why do we need to regulate corporate governance? It looks at the theoretical construct behind various issues in corporate governance and explores some of the theories, which legitimize the use of regulations in market economies.

Section 3 traces the initiatives, regulations, and policy developments with regard to the evolution of corporate governance practice in India. It starts with a description of the voluntary code of corporate governance of CII, the first of its kind in India, and moves on to describe and list out the major recommendations of the Kumar Mangalam Birla committee report and Clause 49 (SEBI), the Naresh Chandra committee report (Department of Company Affairs), and the Narayana Murthy committee report (SEBI).

Section 4 of this mentions the major corporate governance codes/ regulations prevalent in various parts of the world. This sections also benchmarks the existing Companies Act, 1956, Clause 49 and other corporate governance regulations in the country with the widely accepted and well-known OECD principles of corporate governance (2004

Section 5 raises issues that would determine the march of corporate governance in India and shows that market would by itself play a major role in compelling companies to constantly raise the bar when it comes to disclosures and transparency.

Section 6 describes the initiatives and activities that the NGCG proposes to undertake to promote good corporate governance practices in the country.

Section 1: What is Corporate Governance?

Before delving further on the subject, it is important to define the concept of corporate governance. The vast amount of literature available on the subject ensures that there exist innumerable definitions of corporate governance. To get a fair view on the subject it would be prudent to give a *narrow* as well as a *broad* definition of corporate governance.

In a *narrow* sense, corporate governance involves a set of relationships amongst the company's management, its board of directors, its shareholders, its auditors and other stakeholders. These relationships, which involve various rules and incentives, provide the structure through which the objectives of the company are set, and the means of attaining these objectives as well as monitoring performance are determined. Thus, the key aspects of good corporate governance include transparency of corporate structures and operations; the accountability of managers and the boards to shareholders; and corporate responsibility towards stakeholders.

While corporate governance essentially lays down the framework for creating long-term trust between companies and the external providers of capital, it would be wrong to think that the importance of corporate governance lies solely in better access of finance. Companies around the world are realizing that better corporate governance adds considerable value to their operational performance:

- It improves strategic thinking at the top by inducting independent directors who bring a wealth of experience, and a host of new ideas
- It rationalizes the management and monitoring of risk that a firm faces globally
- It limits the liability of top management and directors, by carefully articulating the decision making process
- It assures the integrity of financial reports
- It has long term reputational effects among key stakeholders, both internally and externally

In a *broader* sense, however, good corporate governance- the extent to which companies are run in an open and honest manner- is important for overall market confidence, the efficiency of capital allocation, the growth and development of countries' industrial bases, and ultimately the nations' overall wealth and welfare.

It is important to note that in both the narrow as well as in the broad definitions, the concepts of disclosure and transparency occupy centre-stage. In the first instance, they create trust at the firm level among the suppliers of finance. In the second instance, they create overall confidence at the aggregate economy level. In both cases, they result in efficient allocation of capital.

Having committed to the above definitions, it is important to note that ever since the first writings on the subject appeared in the academic domain, there have been many debates

on the true scope and nature of corporate governance mechanisms around the world. More specifically on the question ‘Who should corporate governance really represent?’ This issue of whether a company should be run solely in the interest of the shareholders or whether it should take account the interest of all constituents¹ has been widely discussed and debated for a long time now. Two definitions of Corporate Governance highlight the variation in the points of view:

‘Corporate governance is concerned with ways of bringing the interests of investors and manager into line and ensuring that firms are run for the benefit of investors’.²

Corporate governance includes ‘the structures, processes, cultures and systems that engender the successful operation of organizations’³

The issue raised here is whether the recognition of claims of a wider set of stakeholders, than those of shareholders alone, is the legitimate concern of corporate governance. If it can be established that there are groups other than shareholders with legitimate claims on companies, and that their involvement in corporate decision making is both a right and is also economically beneficial, then the task of policy makers is to consider: ‘How should the company be regulated so as to enhance its effectiveness as a mechanism for enhancing the overall wealth or well-being of all stakeholders?’

The belief that the purpose of the modern corporation is to maximise shareholder value, along with typical capital market and ownership features, has been associated with the ‘Anglo-Saxon’ agency model of the corporation. This contrasts the ‘German (and Japanese) conception of the company as a social institution’. In making this distinction, commentators have mostly focused on the extent and nature of the separation of ownership and control. The Anglo-Saxon model is said to be characterised by a clear separation between management control and shareholder ownership, and hence is described as an ‘outsider’ system of corporate governance. It is contrasted with the ‘insider’ system, thought to be more descriptive of continental European and Japanese corporate forms.

Shareholder primacy is embodied in the finance view of corporate governance, which is a special instance of the principal-agent framework in economic theory (discussed in Section 2). In terms of the finance view, the primary justification for the existence of the

¹ In its broadest sense the ‘constituents’ may be thought of as those stakeholders who have a ‘moral interest’ or ‘stake’ in the existence and activities of a corporation. In a more narrow sense it embraces, at the core, shareholders and employees, but also extends to certain customers, suppliers and lenders. It is this loose definition of ‘stakeholders’ which we adopt here.

² F. Mayer (1997), ‘Corporate governance, competition, and performance’, In Enterprise and Community: New Directions in Corporate Governance, S. Deakin and A. Hughes (Eds), Blackwell Publishers: Oxford.

³ K. Keasey, S. Thompson and M. Wright (1997), ‘Introduction: The corporate governance problem - competing diagnoses and solutions,’ In K. Keasey, S. Thompson and M. Wright, Corporate Governance: Economic, Management, and Financial Issues. Oxford University Press: Oxford.

corporation is to maximise shareholder wealth. Since ownership and control are separate (for purposes of liquidity, risk sharing and specialisation), the central corporate governance issue from this perspective is aligning the objectives of management with the objective of shareholder wealth maximisation. While companies are encouraged to foster long-term relationships with stakeholders by taking their interests into account, there is no concomitant pressure to build into corporate governance, structures and processes that would ensure company accountability towards stakeholder groups. It is frequently argued that attempts to mediate stakeholder claims may obscure performance evaluation and therefore facilitate discretionary behaviour by management.

The issue raised in the stakeholder theories is whether the recognition of a wider set of claims than those of shareholders alone is the legitimate concern of corporate governance. It is argued that the new high technology world has significantly reduced the opportunity, ability, and motivation of consumers to engage in rational decision making. Therefore, the development of loyal, inclusive stakeholder relationships, rather than the production of a better product at a lower price, will be the most important determinant of commercial viability and business success.

The main intention of the stakeholder's concept as theory is to affirm and show that the company together with its executive board is responsible not only for shareholders but also for individuals or groups that have a stake in the actions and decisions of such organization. Concerning the concept of company, the theory implies understanding the company as a social institution that conforms a plural project in which distinct groups with rights and demands take part. With reference to company manageability, this theory implies searching for a balance among the distinct company interest groups – shareholders, workers, clients, suppliers, banks, subsidiaries, local communities, pressure groups and the like- on part of the executive board. Furthermore, the executive board should also look for participation of those individuals and groups – either directly or by means of representatives- that are somehow linked to the organisation aims.

In India, we have sought to resolve the “shareholder vs. stakeholder” debate by taking the view that since shareholders are residual claimants, in well performing capital and financial markets, whatever maximises shareholder value should maximise corporate prosperity and best satisfy the claims of creditors, employees, shareholders, and the State. Moreover, there exist well-defined laws to protect the interests of employees, and recently framed legislations have considerably strengthened the rights of the creditors. It is therefore appropriate that corporate governance regulations in India seek to promote the rights of shareholders, while at the same time ensuring that the interests of other stakeholders are not adversely impacted.

Section 2: Corporate governance: The need for regulation

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

There are at least three reasons for regulatory intervention. The main reason advocated in favour of mandatory rules is that if the founder of the company was allowed to design and implement a corporate charter he likes, he may not clearly address the issues faced by other shareholders and thus would, in the view of the society, conjure inefficient rules. The functioning of the market for corporate control is an example. In absence of regulations, founders could employ anti-takeover defenses excessively and in the process not allow the capital employed, which is owned by the shareholders, to be used most efficiently. Alternatively, shareholders may favor takeovers that increase the value of their shares even if they involve greater losses for unprotected creditors or employees. Thus, in absence of regulations, the collective bargaining process may not yield socially acceptable solutions and may be at the peril of one or multiple stakeholders

Another argument for mandating regulations of corporate governance comes from the externality argument. An externality may be defined as a good, generated as the result of an economic activity, whose benefits or costs do not accrue directly to the parties involved in the activity. An externality is created by one person and experienced by other (s) and may be positive (a well-maintained garden) or negative (pollution). Bad corporate governance practice by a firm can in the same vein be seen as a negative externality. One corporate failure or scandal can potentially erode shareholders trust in the whole of the corporate sector and thus negatively affect the businesses of honest firms as well. This theory is reinforced by the recent corporate scandals in the United States. A few instances of fraud, as seen in the case of Enron and later on in WorldCom, destroy the faith of investors in the entire corporate sector and thus hurt the larger interest of the economy. Thus in such cases where private action fails to resolve widespread externalities involving large numbers of parties, the state has the responsibility to intervene to provide a level playing field and also to prevent market failure.

In case of dispersed shareholding, due to the (individual) large cost of monitoring the company on a regular basis, there remains a possibility that management may change the rules (to their advantage) ex post. Thus the final argument in support of mandatory rules is to avoid a situation where efficient rules are designed initially but due to lack of active tracking by dispersed shareholders, are altered or broken later.

While regulations are necessary, there are however, a few issues that need to be considered. The first relates to policing and punishment. The SEBI envisages that all these corporate governance norms will be enforced through listing agreements between companies and the stock exchanges. A little reflection suggests that for companies with

little floating stock — which account for more than 85% of the listed companies — de-listing because of non-compliance is hardly a credible threat. The SEBI can, of course, counter that by stating that the reputation effect of de-listing can induce compliance and, hence, better corporate governance.

The second issue is more problematic, and it has to do with form versus substance. There is a fear that by legally mandating several aspects of corporate governance, the regulators might unintentionally encourage the practice of companies ticking checklists, instead of focusing on the spirit of good governance. The fear is not unfounded. Take, for instance, the case of Korea. After the crash of 1998, a part of the IMF bailout package was that a fourth of the board of every listed Korean company must consist of independent directors. They do, but the directors are hardly independent by any stretch of imagination. For most part, they are retired executives of the *chaebols*, friends of business groups and politicians that have supported the business in the past. And, in any event, they don't do what was intended — namely, to speak for shareholders and ensure that management does what is necessary to maximize long-term shareholder value.

The third concern relates to apprehension about excessive interference. There is an apprehension that over-regulation of corporate governance could disrupt the functioning and quality of boards without resulting in any substantial improvement in the standards of corporate governance. It needs to be ensured that we do not go overboard with corporate governance regulations, and that unwittingly micro-management of companies does not take place.

This raises a question of how to trace the line that divides voluntary from mandatory. In an ideal world with efficient capital markets, such a question need not arise — because the markets would recognize which companies are well governed and which are not, and reward and punish accordingly. Unfortunately, ideal capital markets exist only in theory. The reality is quite different. Markets are often thin and shallow and operate on the basis of ebbs and flows of pivotal stocks; informational requirements are lax; and regulatory and policing devices leave much to be desired.

Thus, what is needed a small corpus of legally mandated rules, buttressed by a much larger body of self-regulation and voluntary compliance.

Section 3: Corporate governance initiatives in India

There have been several major corporate governance initiatives launched in India since the mid-1990s. The first was by the Confederation of Indian Industry (CII), India's largest industry and business association, which came up with the first voluntary code of corporate governance in 1998. The second was by the SEBI, now enshrined as Clause 49 of the listing agreement. The third was the Naresh Chandra Committee, which submitted its report in 2002. The fourth was again by SEBI — the Narayana Murthy Committee, which also submitted its report in 2002. Based on some of the recommendation of this committee, SEBI revised Clause 49 of the listing agreement in August 2003. Subsequently, SEBI withdrew the revised Clause 49 in December 2003, and currently, the original Clause 49 is in force.

3.1 The CII Code

More than a year before the onset of the Asian crisis, CII set up a committee to examine corporate governance issues, and recommend a voluntary code of best practices. The committee was driven by the conviction that good corporate governance was essential for Indian companies to access domestic as well as global capital at competitive rates. The first draft of the code was prepared by April 1997, and the final document (*Desirable Corporate Governance: A Code*), was publicly released in April 1998. The code was voluntary, contained detailed provisions, and focused on listed companies.

3.2 Kumar Mangalam Birla committee report and Clause 49

While the CII code was well-received and some progressive companies adopted it, it was felt that under Indian conditions a statutory rather than a voluntary code would be more purposeful, and meaningful.

Consequently, the second major corporate governance initiative in the country was undertaken by SEBI. In early 1999, it set up a committee under Kumar Mangalam Birla to promote and raise the standards of good corporate governance. In early 2000, the SEBI board had accepted and ratified key recommendations of this committee, and these were incorporated into Clause 49 of the Listing Agreement of the Stock Exchanges. Full details of Clause 49 are given in Appendix 1

3.3 The 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 major recommendations of the report are given in Appendix 2.

3.4 Narayana Murthy committee report on corporate governance

The fourth initiative on corporate governance in India is in the form of the recommendations of the Narayana Murthy committee. The committee was set up by SEBI, under the chairmanship of Mr. N. R. Narayana Murthy, to review Clause 49, and suggest measures to improve corporate governance standards. Some of the major recommendations of the committee primarily related to audit committees, audit reports, independent directors, related party transactions, risk management, directorships and director compensation, codes of conduct and financial disclosures. Details of the major recommendations of the committee are given in Appendix 3.

Section 4: The OECD principles and India

“ A code of corporate governance cannot be imported from outside, it has to be developed based on the country’s experience. There cannot be any compulsion on the corporate sector to follow a particular code. An equilibrium should be struck so that corporate governance is not achieved at the cost of the growth of the corporate sector”

-Sir Adian Cadbury

Given the peculiar system of ownership, nature of the financial sector and business practices in each economy, it is imperative that the governance mechanisms are designed to suit their unique nature. Since the mid-1990s, several corporate governance guidelines and regulations have been prepared in different parts of the world. Some of these are:

- Cadbury Committee Report (1992)
- CalPERS- Global Corporate Governance Principles (1996)
- Market Specific Principles- UK and France (1997)
- Market Specific Principles- Japan and Germany (1997)
- Core Principles and Guidelines- USA (April 1998)
- TIAA-CREF- Policy Statement on Corporate Governance (September 1997)
- Business Roundtable- Statement on Corporate Governance (September 1997)
- Hampel Report on Corporate Governance- UK (January 1998)
- The Sarbanes-Oxley Act – USA (August 2002)
- The Higgs Report- UK (January 2003)

At the same time given the increasing interdependence and integration of financial markets around the world it is important that some degree of uniformity and coherence is established in laws of all countries. With this in mind the OECD Council, meeting at Ministerial level on 27-28 April 1998, called upon the OECD to develop, in conjunction with national governments, other relevant international organizations and the private sector, a set of corporate governance standards and guidelines. In order to fulfill this objective, the OECD established the Ad-Hoc Task Force on Corporate Governance to develop a set of non-binding principles that embody the views of OECD countries on this issue.

In this section we benchmark India’s corporate laws, primarily the Companies Act, 1956, and the Clause 49 of the listing agreement of stock exchanges to these principles and highlight the fact that India Inc. conforms to most OECD principles of corporate governance (2004) in terms of governance, transparency and disclosures. The OECD principles are mentioned in bold (and italics) and a small elaboration of appropriate Indian corporate governance guidelines corresponding to these principles is mentioned below.

4.1 Ensuring the basis for an effective corporate governance framework

The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory, and enforcement authorities

A. The corporate governance framework should be developed with a view to its impact on overall economic performance, market integrity and the incentives it creates for market participants and the promotion of transparent and efficient markets.

India has a well-established corporate governance framework and it remained unaffected by the Asian financial crisis of the late 1990s. Indeed, the move towards adopting good corporate governance practices, better financial and non-financial disclosures, and the promotion of transparent and efficient markets in India had built up well before the Asian debacle.

The corporate governance framework in India primarily consists of the following legislations and regulations:

- **The Companies Act, 1956:** Companies in India, whether listed or unlisted, are governed by the Companies Act. The Act is administered by the Department of Companies Act (DCA). Among other things, the Act deals with rules and procedures regarding incorporation of a company; prospectus and allotment of ordinary and preference shares and debentures; management and administration of a company; annual returns; frequency and conduct of shareholders' meetings and proceedings; maintenance of accounts; board of directors, prevention of mismanagement and oppression of minority shareholder rights; and the power of investigation by the government, including powers of the CLB.
- **The Securities Contracts (Regulation) Act, 1956:** It covers all types of tradable government paper, shares, stocks, bonds, debentures, and other forms of marketable securities issued by companies. The SCRA defines the parameters of conduct of stock exchanges as well as its powers.
- **The Securities and Exchange Board of India (SEBI) Act, 1992:** This established the independent capital market regulatory authority, SEBI, with the objective to protect the interests of investors in securities, and promote and regulate the securities market.
- **The Depositories Act, 1996:** This established share and securities depositories, and created the legal framework for dematerialisation of securities.
- **Listing Agreement with stock exchanges:** These define the rules, processes, and disclosures that companies must follow to remain as listed entities. A key element of this is Clause 49, which states the corporate governance practices that listed companies must follow.

B. The legal and regulatory requirements that affect corporate governance practices in a jurisdiction should be consistent with the rule of law, transparent and enforceable.

The regulations listed above are consistent with the rule of law, clearly spelt out, and are enforceable. Both DCA and SEBI have been conferred investigative powers.

C. The division of responsibilities among different authorities in a jurisdiction should be clearly articulated and ensure that the public interest is served.

Listed companies in India fall under the dual jurisdiction of the DCA and SEBI on issue related to corporate governance. While this may not hamper the ability to pursue key corporate governance objective, it results in overlap of jurisdiction on one hand, and additional compliance costs for companies on the other

D. Supervisory, regulatory and enforcement authorities should have the authority, integrity and resources to fulfil their duties in a professional and objective manner. Moreover, their rulings should be timely, transparent and fully explained.

Regulatory authorities, particularly SEBI, have done an excellent job. The rules and regulations made by SEBI to regulate and monitor the capital market are at par with international standards. However regulatory authorities do suffer from lack of more effective powers as well as shortage of key qualified personnel.

4.2 The rights of shareholders and key ownership functions

The corporate governance framework should protect shareholders' rights and facilitate the exercise of shareholder rights.

A. Basic shareholder rights include the right to:

1) Secure methods of ownership registration;

The enactment of Depositories Act in August 1996 paved the way establishing the National Securities Depositories Ltd. (NSDL), the first depository in India. This depository established a national infrastructure of international standard that handles most of the trading and settlement in dematerialised form in Indian capital market. Later, a second depository was introduced, the Central Depository Services Ltd. (CDSL), which maintains equally high standards of safety and efficiency

Registration in depository and the unique account number is proof of ownership for the shareholders.

2) Convey or transfer shares;

There are no restrictions on the transferability of shares, except in the case where the Board may, subject to the right of appeal conferred by section 111 of the Companies Act, decline to register the transfer of shares, not being fully paid shares, to a person they do not approve; on which the company has lien. The free transferability of shares cannot be restricted by private contractual agreements

3) Obtain relevant information on the corporation on a timely and regular basis;

Most of the financial and non-financial information on the companies is available on their websites or other commercial websites free of cost. Apart from this regular filings with Stock Exchanges, SEBI and DCA are also available for shareholders' scrutiny free of cost or at a nominal cost. Moreover, detailed annual accounts are sent to each shareholder, which contain the chairman's letter, management discussion and analysis, directors' report with its annexes, report on corporate governance, additional shareholder information, balance sheet, profit and loss account with all its detailed schedules plus notes on accounts, auditor's note, cash flow statement, etc.

4) Participate and vote in general shareholder meetings;

Board of directors are entrusted with the duty of convening the Annual General Meeting and Extra Ordinary General Meeting. In addition, shareholders may ask the board of directors to hold an Extra Ordinary General Meeting. This is usually known as Requisition Meeting.

Section 166 of the companies Act states that every company must hold an Annual General Meeting (AGM) every year. The gap between two AGMs should not exceed 15 months (Registrar of companies can permit an extension of 3 months in certain cases but in no case it shall exceed 18 months). The notice of the AGM is usually sent to all shareholders 21 days prior to the date of the meeting. Notice of the meeting also includes Annual Report which includes audited annual accounts, directors report, auditors report, agenda for the meeting with explanatory statement. AGM is generally held at the registered office of the company or in a place within the local limits of the city, town or village in which the registered office of the company is situated.

Apart from the AGM, the company may requisition a general meeting if it is called for by shareholders holding 10 % or more of the paid up capital having voting rights. Resolutions that are required to be passed in the general meeting requisitioned by the members have to be circulated in advance by the members.

Once the requisition for the general meeting is received, the board of directors must send the notice of meeting within 21 days to all members. The notice must specify the business proposed to be transacted along with necessary explanatory statement. The general meeting must take place within 45 days from the date of submission of the requisition by the members.

5) Elect and remove members of the board;

Section 257 of the Companies Act, 1956, enables shareholders to elect members of the Board of Directors. Section 284 of the Companies Act enables a company to remove a director through an ordinary resolution.

6) Share in the profits of the corporation.

A company can declare dividends only out of current profits after providing for depreciation; or out of undistributed profits of previous years after providing for depreciation; or out of monies provided by the Central or State Government for the payment of dividend in pursuance to a guarantee given by that Government. Section 205–207A of the Companies Act deals with declaration and distribution of dividends.

Even as the Board of directors are responsible for the declaration of dividend, it has to be approved by the shareholders in annual general meeting must approve such dividends. Shareholders also have the power to reduce the quantum of dividend proposed by the Board of directors though they can never enhance it. Board of directors can authorise interim dividend provided the articles of association permit it. The amount of dividend along with the interim dividend shall be deposited in a separate bank account within five days of the declaration and should be used solely for payment of dividend. A company has to compulsorily transfer a certain percentage of dividend to reserve subject to a maximum of 10 per cent as per Companies (Transfer of Dividend to Reserves) Rules, 1975. A company can also pay dividend by capitalizing its reserves also known as bonus dividend.

Dividend declared by a company has to be paid within a period of thirty days. Any default in payment of dividend may result in imprisonment of directors or officers of the company, if he is knowingly a party to the default. A prison term of three years and a fine of one thousand rupees for every day during which the default continues may be imposed.

However, no offence is deemed to have been committed in the following cases-

- a) where dividend could not be paid by reason of the operation of law,
- b) where a shareholder has given directions to the company regarding the payment and those directions cannot be complied with,
- c) where there is a dispute regarding the right to receive the dividend,
- d) where the dividend has been lawfully adjusted against any sum due from the shareholder,
- e) where, for any other reason, failure was not due to any default on the part of the company.

B. Shareholders should have the right to participate in, and to be sufficiently informed on, decisions concerning fundamental corporate changes such as:

1) Amendments to the statutes, or articles of incorporation or similar governing documents of the company;

Shareholders have the right to participate, be sufficiently informed and vote on amendments to company articles or statute; appointment and removal of directors; appointment and removal of auditors; authorizing share capital; issuing share capital; remuneration of board members; major corporate transactions, such as acquisitions, disposals, mergers and takeovers; transactions with related parties and changes to company business, or objectives among other things. Some of these resolutions require simple majority of the shareholders while others require 75 per cent majority.

2) The authorisation of additional shares;

As mentioned earlier, pursuant to the Companies Act, 1956, shareholders have the right to participate in the decision to issue new shares. To raise fresh capital a company is required to pass a special resolution (requiring approval by over 75% of shareholders, present and voting) to this effect.

3) Extraordinary transactions including the transfer of all or substantially all assets, that in effect result in the sale of the company

Section 293 restricts the Board of directors of a company to “sell, lease or otherwise dispose of the whole, or substantially the whole, of the undertaking of the company” without passing a resolution in a general meeting to this effect.

C. Shareholders should have the opportunity to participate effectively and vote in general shareholder meetings and should be informed of the rules, including voting procedures that govern general shareholder meetings:

1. Shareholders should be furnished with sufficient and timely information concerning the date, location and agenda of general meetings, as well as full and timely information regarding the issues to be decided at the meeting.

The notice of the AGM (as specified in Section 171) is sent to all shareholders at least 21 days prior to the date of the meeting. Notice of the meeting also includes Annual Report which includes audited annual accounts, directors report, auditors report, agenda for the meeting with explanatory statement. AGM is generally held at the registered office of the company or in a place within the local limits of the city, town or village in which the registered office of the company is situated.

In case of general meetings, once the board of directors receives the requisition, it must send the notice of meeting within 21 days to all members. The general meeting must take place within 45 days from the date of submission of the requisition by the members. As

specified in Section 172, the notice must specify the place, date and hour of the meeting and contain a statement of the business to be transacted.

Section 173 states that in case of special businesses, a statement setting out all material facts concerning each such item including in particular the nature of the concern or interest, if any, therein, of any director or a manager has to be attached with the notice of the meeting.

2. Opportunity should be provided for shareholders to ask questions of the board, including questions related to the annual external audit, to place items on the agenda of general meetings, and to propose resolutions subject to reasonable limitations.

According to section 188 of the Companies Act, 1956, a company is required to, on the requisition in writing of shareholders holding at least 5% of voting power, circulate amongst all shareholders the notice of any resolution, which is intended to be moved by the requisitionists at the general meeting. The company is also required to circulate to all shareholders, any statement (of not more than one thousand words) with respect to the matter referred to in any proposed resolution. At the meeting, shareholders are allowed, subject to reasonable limitations, to ask questions and speak otherwise.

Clause 49 of the listing agreement of the stock exchanges stipulates that the chairman of the Audit Committee should be present at the general meeting to respond to shareholder queries

3. Effective shareholder participation in key corporate governance decisions, such as the nomination of and election of board members, should be facilitated. Shareholders should be able to make their views known on the remuneration policy for board members and key executives. The equity component of compensation schemes for board members and employees should be subject to shareholder approval.

The right of the shareholders to elect and remove directors has been discussed earlier. Section 309 provides that the remuneration payable to directors should be determined either by the articles of the company, or by a resolution, or if the articles so required, by a special resolution, passed by the company in general meeting.

4. Shareholders should be able to vote in person or in absentia, and equal effect should be given to votes whether cast in person or in absentia.

Shareholders, according to Section 176 of the Companies Act, may vote in absentia by appointing a proxy. The proxy so appointed may or may not be shareholders of the company. A proxy can demand a poll and cast his vote, though he cannot speak at the meeting. Notice convening the meeting must state that a member can appoint a proxy.

Also according to the provisions of section 154, the registration of transfers may be suspended at such times and for such periods as the Board may decide from time to time. Section 154 of the Companies Act states that a company may, after giving not less than

seven days notice by advertisement , close the register of members or debenture holders for any period or periods exceeding in aggregate 42 days in each year (but not exceeding 30 days at any one time).

D. Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership should be disclosed.

According to Companies (Issue of Share Capital with Differential Voting Rights) Rules, 2001, public companies have to obtain approval of its shareholders by passing a resolution, in general meeting, to increase its share capital by issuing new shares with differential voting rights;

The notice of the meeting at which the resolution is to be passed should contain an explanatory statement as under:

- The rate of voting rights, which the equity share capital with differential voting rights shall carry;
- The scale or proportion of variation of voting rights;
- An undertaking that the company shall not convert its equity share capital with voting rights into equity share capital with differential voting rights or vice versa;
- A statement that the shares with differential voting rights shall not exceed 25% of the total issued share capital of the company;
- A statement specifying the entitlement of a member of the company holding equity shares with differential voting right to bonus shares, or right shares of the same class;
- A statement specifying that holders of equity shares with differential voting rights shall enjoy all other rights to which they are entitled, except the right to vote as provided under (1) above

Also, Clause 49 of the listing agreement mandates each listed company to disclose their capital structure extensively.

E. Markets for corporate control should be allowed to function in an efficient and transparent manner.

- 1. The rules and procedures governing the acquisition of corporate control in the capital markets, and extraordinary transactions such as mergers, and sales of substantial portions of corporate assets, should be clearly articulated and disclosed so that investors understand their rights and recourse. Transactions should occur at transparent prices and under fair conditions that protect the rights of all shareholders according to their class.**

Since the Securities and Exchange Board of India or SEBI framed the takeover code in 1997 the equity side of the market for corporate control has become very transparent. Popularly known as the takeover code, the major provisions of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulation, 1997 are:

- **Disclosure.** Any person or body corporate whose shareholding crosses the 5% threshold has to publicly disclose this to the relevant stock exchange and to SEBI.
- **Trigger.** SEBI initially specified a 10% trigger. If an acquirer's shareholding crossed 10%, he (person or body corporate) had to make an open offer for at least an extra 20% of the shares. In other words, for market purchases, a slow rise in shareholding from 9.9% to say 11.9% is no longer permissible. If the acquirer crosses the 10% threshold, he must purchase at least 30%. Given the structure of share ownership in corporate India, SEBI believes — and rightly so — that 30% generally suffices to give controlling interest. In 2001, the trigger was raised from 10% to 15%.
- **Minimum offer price.** Any such public offer must carry a minimum price which is the average of the market price for the last six months.
- **Creeping acquisition.** Existing management is allowed to consolidate its holdings through the secondary market so long as such acquisition does not annually exceed 2% of the shares. This was subsequently raised to 5% in 2001. The creeping acquisition provision is aimed to allow management to gradually consolidate its ownership without detriment to minority shareholders.
- **Escrow.** To ensure that the takeover bids are serious, there has to be an escrow account to which the acquirer has to deposit 25% of the value of his total bid. He loses this in the event of his winning the bid but reneging on timely payment.

The SEBI regulation has had two beneficial effects. First, it has created a transparent market for takeovers. Second, by legislating in favour of open offers, it has ensured that minority shareholders will have the right to obtain a market driven price in any takeover. Moreover, while friendly takeovers are still the norm, hostile takeovers have begun. And the SEBI Takeover Code has been already tested in at least 25 hostile bids, and has come out more robust than before.

For mergers and de-mergers, the companies concerned must go through the following steps:

- First, secure approval of their respective board of directors.
- Second, appoint valuers for doing the valuation and, hence, the share-swap ratio.
- Third, secure approval from shareholders in a shareholders' meeting.
- Fourth, get approval from the High Court about the arrangement of merger or de-merger.

2. Anti-take-over devices should not be used to shield management from accountability.

Defensive tactics such as poison pills are banned by law. Sometimes, however, in the face of a hostile takeover, the target company may get a white knight to make a counter-bid. When that happens, the white knight will also have to follow the SEBI'

F. The exercise of ownership rights by all shareholders, including institutional investors, should be facilitated

- 1. Institutional investors acting in a fiduciary capacity should disclose their overall corporate governance and voting policies with respect to their investments, including the procedures that they have in place for deciding on the use of their voting rights**
- 2. Institutional investors acting in a fiduciary capacity should disclose how they manage material conflicts of interest that may affect the exercise of key ownership rights regarding their investments.**

This is a new principle that has been incorporated in the revised OECD principles of corporate governance enunciated in 2004. At present, there are no official guidelines mandating these disclosures. In general institutional investors are seen to use their voting rights very judiciously and in the interest of the company and shareholders. In certain cases they can block and amend resolutions, they feel are not in the interest of the company, public or shareholders.

G. Shareholders, including institutional shareholders, should be allowed to consult with each other on issues concerning their basic shareholders rights as defined in the Principles, subject to exception to prevent abuse.

This, too, is a new principle. Institutional investors often consult each other on how to vote on a particular issue and it has been observed that they generally vote together.

4.3 The equitable treatment of shareholders

The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.

A. All shareholders of the same class should be treated equally.

- 1. Within any class, all shareholders should have the same voting rights. All investors should be able to obtain information about the rights attached to all series and classes of shares before they purchase. Any changes in voting rights should be subject to approval by those classes of shares, which are negatively affected.**

The Companies Act specifies only are two types of shares- equity and preference. Ordinary shares are freely transferable and carry voting rights based on one-share-one vote. There are no differential classes of voting shares in India. If a share is entitled to vote, it is an ordinary share, and each such share carries one vote. Preference shares carry no voting rights but are committed to pre-committed, fixed dividends, which are cumulative in nature. In times of redemption or during winding up, preference shareholders get preference over ordinary equity shareholders.

2. Minority shareholders should be protected from abusive actions by, or in the interest of, controlling shareholders, acting either directly or indirectly, and should have effective means of redress.

The Companies Act confers fairly strong rights to shareholders in matters dealing with oppression by minority or mismanagement. Section 397 of the Act deals with relief in the case of oppression and section 398 with mismanagement. In either case, 100 or more shareholders, or a number representing at least one-tenth of the total number of shareholders, whichever is less, can apply to the Company Law Board if they believe that that the affairs of the company are being conducted in a manner prejudicial to the public interest or to the interest of the company, or in a manner oppressive to any shareholder. Shareholders can also file an application if mismanagement arises due to a change in the board or control of the company, which they believe, can result in affairs of the company being conducted in a manner prejudicial to public interest or to the interest of the company.

In such cases, the CLB, can if it sees fit, order to end such oppression/mismanagement by : i) directing the manner in which affairs of the company would be conducted in the future; ii) ordering the majority to purchase the shares held by the oppressed minority; iii) terminating, setting aside or modifying any agreement with the management; or iv) by other means thought equitable.

3. Votes should be cast by custodians or nominees in a manner agreed upon with the beneficial owner of the shares.

Unlike in some OECD countries, the votes of shareholders not present at the meeting are not automatically cast in favour of the management. Also institutional investors do not, by default, vote in favour of the management and may, depending on their judgement, vote differently

4. Processes and procedures for general shareholder meetings should allow for equitable treatment of all shareholders. Company procedures should not make it unduly difficult or expensive to cast votes.

As mentioned earlier the general shareholder meetings are accessible to all shareholders and their proxies. There are no significant costs involved with voting. Postal voting was introduced in the Companies Act, 1956 in 2001 under section 192A. Though not mandatory, a company may seek postal voting on the following resolutions:

- (a) alteration in the Object Clause of Memorandum
- (b) alteration of Articles of Associations in relation to deletion or insertion of provisions defining private company
- (c) buy-back of own shares by the company
- (d) issue of shares with differential voting rights as to voting or dividend
- (e) change in place of Registered Office out side local limits of any city, town or village
- (f) sale of whole or substantially the whole of undertaking of a company
- (g) giving loans or extending guarantee or providing security in excess of the limit prescribed under sub-section (1) of section 372A
- (h) election of a director
- (i) power to compromise or make arrangements with creditors and members as specified
- (j) variation in the rights attached to a class of shares or debentures or other securities

B. Insider trading and abusive self-dealing should be prohibited.

While insider-trading regulations were framed in 1992, it was felt that there was no framework for prevention of insider trading. Consequently, The Insider Trading (Amendment) Regulations were notified on February 20, 2002. The following changes have been made through these amendment regulations:

1. Strengthening Existing Provisions

Several existing provisions were amended to strengthen the regulations. These amendments include changes in the definition of connected person, broadening the meaning of dealing in securities, redefining the term 'deemed to be connected', re-framing the term 'unpublished price sensitive information', and amendments to the procedure of investigations, in addition to other amendments.

2. Incorporation of disclosure requirements by insiders such as directors and large shareholders

A new regulation has been included providing for initial and continual disclosure of shareholding by directors or officers and substantial shareholders (holding more than 5 per cent shares/ voting rights) of listed companies. These disclosures are to be made to the companies, which have to inform the stock exchanges within the prescribed time period. This requirement will further enhance transparency in the market.

3. Creation of preventive framework consisting of code of conduct for listed companies and other entities associated with securities markets

To create a preventive framework to curb insider trading, all listed companies and other entities associated with securities market are now required to adopt a code of conduct on the lines of the model code specified in the regulations. The codes of conduct cover the following aspects: Maintaining confidentiality of “Unpublished Price Sensitive Information”

- Trading restrictions such as Trading windows, restricted lists of securities and pre-clearance of trades
- Internal reporting Requirements for transactions in securities
- Provisions for internal enforcement and penalty to be imposed by companies/ other entities
- for contravention of code of conduct

4. Creation of a code of corporate disclosure practices for listed companies

Listed companies are now required to adopt a code for corporate disclosure to improve transparency in the market and fairness in the dissemination of information by corporates to the market. This code covers the areas of :

- Prompt disclosure of price sensitive information by listed companies
- Responding to market rumours
- Timely Reporting of shareholdings/ ownership and changes in ownership
- Disclosure of Information with special reference to Analysts, Institutional Investors
- Dissemination of information by companies including through company websites.

5. Dissemination off price sensitive information to public

To have a proper method for dissemination of price sensitive and other important information relating to companies and market to the public, the stock exchanges have been advised to display such information on their terminals in the quickest possible manner.

6. Dealing with market rumours

Companies are required to designate compliance officers who can be contacted by the stock exchanges whenever such verification is needed. Exchanges are required to take up quick verification of rumours and ensure proper dissemination of the relevant information. Exchanges routinely scan newspapers to verify unconfirmed news reports and disseminate information to the market. In addition, exchanges have also been advised to verify rumours pertaining to specific market entities.

7. Co-ordination and sharing of information

The exchange has to designate a senior level official handling surveillance function to co-ordinate with other exchanges on surveillance matters. Major exchanges have instituted coordination in crucial areas related to market functioning, and also meet periodically to discuss relevant issues.

C. Members of the board and key executives should be required to disclose to the board whether they, directly, indirectly, or on behalf of third parties, have a material interest in any transactions or matter directly affecting the corporation.

Section 299 of the Companies Act, 1956, specifies that every director of a company who is in any way, whether directly or indirectly, concerned or interested in a contract or arrangement, should disclose the nature of his concern or interest to the Board. According to section 297 of the Companies Act, the board of directors have to give their consent on any such related party transactions. Further, under the provisions of Section 300, the “interested” director is not allowed to take part in the discussions or vote on any contract entered into in which he is interested.

4.4. The role of stakeholders in corporate governance

The corporate governance framework should recognise the rights of stakeholders as established by law or through mutual agreements, and encourage active cooperation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.

A. The rights of stakeholders that are established by law or through mutual agreements are respected.

The rights of creditors

Secured creditors such as banks, development financial institutions (DFIs) and insurance companies offering long term debt, have the right to be represented on the board through their representatives who, in India, are called ‘nominee directors’. This right arises from the contract executed between the company and the creditor organisation, and is enforced through the covenants of such a contract. Almost all major listed companies belonging to Group A and B1 of the BSE which have sizeable debt from banks, DFIs and insurance companies have nominee directors.

Creditors also have the right to block dividend payments if their dues have not been paid. This involves all debt dues, including payment towards debentures or bonds; this right is enforced by petitioning the civil courts, the Company Law Board or High Courts.

Creditors’ rights are supreme in bankruptcy restructuring or liquidation. Under the Companies Act, 1956, the Sick Industrial Companies Act, 1985, (SICA), and the Debt Recovery Act, 1992, creditors have the right to take a company to bankruptcy court, civil courts, High Courts or Debt Recovery Tribunals for securing their dues either through receivers, or via bankruptcy restructuring or winding up procedures. Under section 19 of

SICA, secured creditors have the right to veto any bankruptcy restructuring plan proposed by the debtor company, and this veto right is binding. In winding up under the Companies Act, creditors and workmen (as defined by the Industrial Disputes Act, 1947) have pari passu rights over all other claimants to recover through asset sale their unpaid debt and wages / salaries, respectively.

Recently, the Government of India enacted the Securitization Act where creditors have the right to foreclose on debt and its mortgaged assets in the event of the account becoming a non-performing loan — defined as one in which payments have not been made for two successive quarters.

The rights of employees

All employees, workmen or otherwise, have the right to form trade unions. The Industrial Disputes Act, the Factories Act and the Contract Labour Act say that workers cannot be fired, retrenched or laid-off without due cause and without following due process. If anything, these processes are biased in favour of workers. In bankruptcy restructuring, representatives of workers have the legal right to participate in the proceedings. As mentioned earlier, in winding up, workers have pari passu rights (along with secured creditors) to their unpaid wages.

B. Where stakeholder interests are protected by law, stakeholders should have the opportunity to obtain effective redress for violation of their rights.

Creditors

Creditors can, and do, petition the Company Law Board, the Board for Industrial and Financial Reconstruction (BIFR, the special bankruptcy court under SICA), civil courts, High Courts and Debt Recovery Tribunals for violation of their rights. This is routinely done in instances of violation.

Workers and employees

Workers and employees can petition civil courts and High Courts. This is regularly done in cases of violation. However, workmen of a company are not allowed to file petition for winding up. Workers may be allowed to appear and be heard in support or opposition of the winding up petition.

C. Performance-enhancing mechanisms for stakeholder participation should be permitted to develop.

ESOPs are increasingly becoming popular in companies. The Securities and Exchange Board of India (SEBI) has prescribed a detailed guideline on the issue of share options (available under the section on guidelines on www.sebi.gov.in). For unlisted companies, Department of Company Affairs (DCA) has recently come out with a report on ESOP, Sweat Equity and Preferential Allotment, which has made detailed recommendations on the subject. This report is available on www.dca.nic.in.

D. Where stakeholders participate in the corporate governance process, they should have access to relevant, sufficient and reliable information on a timely and regular information.

All relevant communication from a listed company must be posted on the company's website, which includes presentations to analysts. Besides, annual, half-yearly and quarterly financial results have to be published in national newspapers, sent to the stock exchanges and SEBI, and be posted on the website.

E. Stakeholders, including individual companies and their representative bodies, should be able to freely communicate their concerns about illegal or unethical practices to the board and their rights should not be compromised for doing this.

The Narayana Murthy committee has proposed that all listed companies adopt a whistle blower policy. According to this proposed policy:
“ Personnel who observe an unethical or improper practice (not necessarily a violation of law) should be able to approach the audit committee without necessarily informing their supervisors. Companies shall take measures to ensure that this right of access is communicated to all employees through means of internal circulars, etc. The employment and other personnel policies of the company shall contain provisions protecting “whistle blowers” from unfair termination and other unfair prejudicial employment practices.”

F. The corporate governance framework should be complemented by an effective, efficient insolvency framework and by enforcement of creditor rights

The Sick Industrial Companies (Special Provisions) Act, 1985, popularly known as SICA, lays down the framework for bankruptcy restructuring of financially distressed companies. The process, which is supervised by the Board for Financial and Industrial Restructuring (BIFR), does have its flaws and there is definite scope for improvement.

By law, creditors have prior claim over shareholders. When their contractual obligations are not met, creditors can demand bankruptcy reorganisation under SICA, file for winding up of the company or apply for receivership. In addition, since 1993, banks and financial institutions can take recourse to another alternative— that of filing for recovery of dues at the Debt Recovery Tribunals (DRTs).

In an important development, the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, has been enacted. This Act has three important aspects: to establish asset reconstruction companies for non-performing loans; to allow for securitisation of loans and other securities; and to allow expeditious attachment and foreclosure of NPLs.

4.5 Disclosure and transparency

The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.

A. Disclosure should include, but not be limited to, material information on:

- 1. The financial and operating results of the company.**
- 2. Company objectives.**
- 3. Major share ownership and voting rights.**
- 4. Remuneration policy for members of the board and key executives, and information about board members, including their qualifications, the selection process, other company directorships, and whether they are regarded as independent by the board**
- 5. Related party transactions**
- 6. Material foreseeable risk factors.**
- 7. Material issues regarding employees and other stakeholders.**
- 8. Governance structures and policies, in particular, the content of any corporate governance code or policy and the process by which it is implemented.**

Most of this information is routinely disclosed by the company to its shareholders. The details of the disclosures made by listed companies in India is mentioned in the table below :

Type of disclosure	Statutory or non-statutory	Disclosure to whom
Annual Report		
Chairman's letter	Non-statutory	Shareholders, stock exchanges, analysts, investors, SEBI, DCA, Registrar of Companies (ROC)
Management discussion and analysis	Statutory	Shareholders, stock exchanges, analysts, investors, SEBI, DCA, ROC
Directors report and annexes	Statutory	Shareholders, stock exchanges, analysts, investors, SEBI, DCA, ROC
Balance sheet with its schedules	Statutory	Shareholders, stock exchanges, analysts, investors, SEBI, DCA, ROC
Profit and loss account with its schedules	Statutory	Shareholders, stock exchanges, analysts, investors, SEBI, DCA, ROC
Notes on accounts, significant accounting policies, auditor's certification	Statutory	Shareholders, stock exchanges, analysts, investors, SEBI, DCA, ROC

Segment accounts	Statutory	Shareholders, stock exchanges, analysts, investors, SEBI, DCA, ROC
Cash flow statement	Statutory	Shareholders, stock exchanges, analysts, investors, SEBI, DCA, ROC
Report on corporate governance with certification of the Company Secretary and the auditor	Statutory	Shareholders, stock exchanges, analysts, investors, SEBI, DCA, ROC
General shareholder information	Statutory	Shareholders, stock exchanges, analysts, investors, SEBI, DCA, ROC
Financial disclosure for the press, SEBI and stock exchanges as per the SEBI format	Statutory	Shareholders, stock exchanges, analysts, investors, SEBI, DCA, ROC
Half yearly disclosures		
Half-yearly audited profit and loss account, with notes	Statutory	Shareholders, stock exchanges, analysts, investors, SEBI, DCA, ROC
Quarterly disclosures		
Quarterly non-audited profit and loss account, with notes	Statutory	Shareholders, stock exchanges, analysts, investors, SEBI, DCA, ROC

B. Information should be prepared, audited, and disclosed in accordance with high quality standards of accounting, financial and non-financial disclosure, and audit.

Auditing standards in India are materially in line with International Standards on Auditing (ISA). These include Ethical requirements (as described in ISA 100) and the IFAC Code of Ethics for Professional Accountants.

C. An annual audit should be conducted by an independent, competent, and qualified auditor in order to provide an external and objective assurance to the board and shareholders that the financial statements fairly represent the financial position and performance of the company in all material respects.

Annual audit is mandated by the Companies Act. The auditors are independent, and under Section 226 Clause (3) of the Companies Act (1956) the following are not eligible for appointment as auditors;

- A) Body corporate
- B) Officer or employee of the company
- C) A person who is a partner or in employment of an officer or employee of the company
- D) A person indebted to the company for an amount exceeding Rest. 1000; or which has given any guarantee or provided any security in connection with the indebtedness
- E) A person holding any security carrying voting rights if the company

Apart from the above, according to the Companies Act and Clause 49 of the Listing Agreement with stock exchanges (and the proposed Companies (Amendment) Bill, 2003) all widely held companies with paid-up capital and free reserves in excess of Rs.100 million or turnover in excess of Rs.500 million must have an Audit Committee of the board — consisting of only non-executive directors and having at least three members. Given below are the mandated roles and responsibilities of the Audit Committee under Clause 49 of the Listing Agreement.

Key information that must be reported to, and placed before, the Audit Committee of the board as well, must contain:

- Annual operating plans and budgets, together with up-dated long term plans.
- Capital budgets, manpower and overhead budgets.
- Quarterly results for the company as a whole and its operating divisions or business segments.
- Internal audit reports, including cases of theft and dishonesty of a material nature.
- Show cause, demand and prosecution notices received from revenue authorities which are considered to be materially important.
- Fatal or serious accidents, dangerous occurrences, and any effluent or pollution problems.
- Default in payment of interest or non-payment of the principal on any public deposit, and/or to any secured creditor or financial institution.
- Defaults such as non-payment of inter-corporate deposits by or to the company, or materially substantial non-payment for goods sold by the company.

- Any issue which involves possible public or product liability claims of a substantial nature, including any judgment or order which may have either passed strictures on the conduct of the company, or taken an adverse view regarding another enterprise that can have negative implications for the company.
- Details of any joint venture or collaboration agreement.
- Transactions that involve substantial payment towards goodwill, brand equity, or intellectual property.
- Recruitment and remuneration of senior officers just below the board level, including appointment or removal of the Chief Financial Officer and the Company Secretary.
- Labour problems and their proposed solutions.
- Quarterly details of foreign exchange exposure and the steps taken by management to limit the risks of adverse exchange rate movement, if material.

D. External auditors should be accountable to the shareholders and owe a duty to the company to exercise due professional care in the conduct of the audit

Clause 49 stipulates that the appointment and removal of external auditors is recommended by the audit committee of the board

E. Channels for disseminating information should provide for fair, timely and cost-efficient access to relevant information by users.

As mentioned earlier, the annual report of the company along with its audited accounts are sent to all shareholders, to SEBI, DCA, ROC, the stock exchanges, and posted on the company's website. In addition, key elements of the balance sheet and profit and loss account, segment accounts and cash flow statement along with notes is reported in national newspapers.

Key elements of the audited half-yearly accounts, as defined by the SEBI, are published in national newspapers, submitted to SEBI, DCA, ROC, the stock exchanges and the company's website.

Similarly, elements of the non-audited quarterly accounts, as defined by the SEBI, are published in national newspapers, submitted to SEBI, DCA, ROC, the stock exchanges and the company's website.

Annual accounts have to be prepared within six months of the end of the financial year. The Companies (Amendment) Bill, 2003, proposes to reduce this period to three months.

Half yearly accounts have to be prepared within two months of the end of the six-month period. Quarterly accounts have to be prepared within one month of the end of the quarter.

- F. The corporate governance framework should be complemented by an effective approach that addresses and promotes the provisions of analysis or advice by the analysts, brokers, rating agencies and others that is relevant to decisions by investors, free from material conflicts of interest that might compromise the integrity of their analysts and advice.**

The Naryana Murthy Committee has recommended that SEBI should make it mandatory for a security analyst to disclose in his report whether the company that is being written about is a client of the analyst's employer or an associate of the analyst's employer. The analyst should also disclose whether he or his employee or an associate holds, has held, or intends to hold any debt or equity instrument in the company that is the subject matter of the report.

4.6 The responsibilities of the board

The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

- A. Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders.**

By law, the Board of the company is accountable to the company i.e. the shareholders. The Fiduciary Duty of the Directors is implicit in the the common law system. The fiduciary duty of the directors obligates them not to exceed their authority and powers and to act with honesty and good faith. They should not engage in any activity which is *ultra vires* the company or illegal. Directors must not use unpublished or confidential information belonging to the company for their own purpose. Any knowledge or information that is generated by the company is its own property, and any gain on information should accrue to the company and not to the individual.

A director has to take reasonable care in performance of his duties. He need not be an expert in any particular field or in the activities of the company and might not have any extraordinary skill or knowledge. However, he is expected to be not negligent in performing his duties.

Individually, the members of the board are subjected to the following liabilities (as described in the Companies Act (1956)):

- Under Section 322 and 323, in a limited company the liability of all or any of the directors or managers is unlimited. Any person being proposed to the office of a director or any other management personnel should be informed in writing, before he accepts the office, that his liability will be unlimited and the proposal shall contain a statement to that effect.
- A director, being in the fiduciary position of a trustee for the company, may incur liability for breach of his fiduciary duty to the company

- Directors are personally liable for the following Acts:
 - For *ultra vires* acts: The act on the part of the directors *ultra vires* the company may render liable to indemnify the company in respect of any consequent loss or damages sustained. If the directors use the company's money for purposes, which the company cannot sanction, they become personally liable to replace it, however, honestly they may have acted
 - For mala fide acts: If the directors act dishonestly and in breach of trust or misfeasance in that capacity, they are liable to account for and surrender profits to their company. Also, they should make good the loss sustained by the company by reason of the mala fide exercise of any of the powers vested in them
 - For negligence: If directors are negligent in discharging their duties, they may be liable to their company for loss sustained due to their negligence
 - Liability to the third parties: In certain circumstances, directors may incur personal liability to third parties

Under the Companies Act, criminal proceedings against directors may be also be initiated, for actions such as :

- Filing of prospectus containing untrue statements
- Inviting deposits in contravention of rules or manner or conditions
- Issuing false advertisement inviting deposits
- Concealing name of the creditors
- Default in distributing dividends
- Failure to assist the Registrar or any officer authorized by central government in inspection of the books
- Failure to lay balance sheet in the Annual General Meeting (AGM)
- Failure in compliance with regard to matters being stated in the balance sheet
- Failure to attach to balance sheet a report of the board
- Improper issue of shares
- Failure to disclose shareholdings in the company
- False declaration of a company's solvency

For such offences, monetary penalties ranging from Rs.1000 to Rs.100,000 and/or imprisonment between six months to five years can be imposed.

B. Where board decisions may affect different shareholder groups differently, the board should treat all shareholders fairly.

As mentioned earlier the fiduciary duty of the directors obligates them to treat all shareholders equally and fairly

C. The board should apply high ethical standards. It should take into account the interests of stakeholders.

D. The board should fulfil certain key functions, including:

- 1. Reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans; setting performance objectives; monitoring implementation and corporate performance; and overseeing major capital expenditures, acquisitions and divestitures.**
- 2. Monitoring the effectiveness of the company's governance practices and making changes as needed**
- 3. Selecting, compensating, monitoring and, when necessary, replacing key executives and overseeing succession planning.**
- 4. Aligning key executive and board remuneration with the longer-term interests of the company and its shareholders.**
- 5. Ensuring a formal and transparent board nomination and election process.**
- 6. Monitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions.**
- 7. Ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for monitoring risk, financial control, and compliance with the law.**
- 8. Overseeing the process of disclosure and communications.**

Among the mandated duties of the board are to review as mentioned in Clause 49 of the listing agreement:

- Fatal or serious accidents, dangerous occurrences, and any effluent or pollution problems.
- Show cause, demand and prosecution notices received from revenue authorities which are considered to be materially important.
- Default in payment of interest or non-payment of the principal on any public deposit, and/or to any secured creditor or financial institution.
- Defaults such as non-payment of inter-corporate deposits by or to the company, or materially substantial non-payment for goods sold by the company.
- Any issue which involves possible public or product liability claims of a substantial nature, including any judgment or order which may have either passed strictures on the conduct of the company, or taken an adverse view regarding another enterprise that can have negative implications for the company.
- Labour problems and their proposed solutions.
- Non-payment of statutory dues to employees.

The board has to review, on a quarterly basis, at least the following:

- Annual operating plans and budgets, together with up-dated long term plans.
- Capital budgets, manpower and overhead budgets.
- Quarterly results for the company as a whole and its operating divisions or business segments.
- Internal audit reports, including cases of theft and dishonesty of a material nature.
- Show cause, demand and prosecution notices received from revenue authorities which are considered to be materially important.
- Fatal or serious accidents, dangerous occurrences, and any effluent or pollution problems.
- Default in payment of interest or non-payment of the principal on any public deposit, and/or to any secured creditor or financial institution.
- Defaults such as non-payment of inter-corporate deposits by or to the company, or materially substantial non-payment for goods sold by the company.
- Any issue which involves possible public or product liability claims of a substantial nature, including any judgment or order which may have either passed strictures on the conduct of the company, or taken an adverse view regarding another enterprise that can have negative implications for the company.
- Details of any joint venture or collaboration agreement.
- Transactions that involve substantial payment towards goodwill, brand equity, or intellectual property.
- Recruitment and remuneration of senior officers just below the board level, including appointment or removal of the Chief Financial Officer and the Company Secretary.
- Labor problems and their proposed solutions.
- Quarterly details of foreign exchange exposure and the steps taken by management to limit the risks of adverse exchange rate movement, if material.

E. The board should be able to exercise objective judgement on corporate affairs independent, in particular, from management.

1. Boards should consider assigning a sufficient number of non-executive board members capable of exercising independent judgment to tasks where there is a potential for conflict of interest. Examples of such key responsibilities are ensuring the integrity of financial and non-financial reporting, the review of related party transactions, nomination of board members and key executives, and board remuneration.

According to the Clause 49 of the listing agreement, at least 50 per cent of the Board of directors of a company should consist of non-executive directors. The number of independent directors depends on whether the Chairman is executive or non-executive. In

case of a non-executive Chairman, at least one third of the board should comprise independent directors; if on the other hand the Chairman is executive at least half of the board should comprise independent directors.

Clause 49 has made it mandatory for all Indian listed companies to constitute an audit committee, consisting of non-executive directors, majority of whom are independent. The chairman of this committee has to be an independent director. The duties of the audit committee include oversight of the financial reporting process of the company and review of related party transactions.

In addition, a non-mandatory provision of clause 49 provides for the formation of a remuneration committee to fix the remuneration of executive directors. This committee must constitute of non-executive directors with an independent director being the chairman.

2. When committees of the board are established, their mandate, composition and working procedures should be well defined and disclosed by the board.

Clause 49 stipulates that all board committees (audit, remuneration, and shareholder committees) disclose their composition, terms of reference, name of members, and attendance record in their annual report.

3. Board members should devote sufficient time to their responsibilities.

The company, as part of the non-financial disclosures, has to mention in its annual report the total number of meetings of the board held in the year and the number of meetings attended by each member of the board.

F. In order to fulfil their responsibilities, board members should have access to accurate, relevant and timely information.

Schedule 1A of Clause 49 of the listing agreement mandates that the board of directors be provided (at least) the following information on a quarterly basis

1. Annual operating plans and budgets and any updates.
2. Capital budgets and any updates.
3. Quarterly results for the company and its operating divisions or business segments.
4. Minutes of meetings of audit committee and other committees of the board.
5. The information on recruitment and remuneration of senior officers just below the board level, including appointment or removal of Chief Financial Officer and the Company Secretary.
6. Show cause, demand, prosecution notices and penalty notices which are materially important
7. Fatal or serious accidents, dangerous occurrences, any material effluent or pollution problems.

8. Any material default in financial obligations to and by the company, or substantial non-payment for goods sold by the company.
9. Any issue, which involves possible public or product liability claims of substantial nature, including any judgement or order which, may have passed strictures on the conduct of the company or taken an adverse view regarding another enterprise that can have negative implications on the company.
10. Details of any joint venture or collaboration agreement.
11. Transactions that involve substantial payment towards goodwill, brand equity, or intellectual property.
12. Significant labour problems and their proposed solutions. Any significant development in Human Resources/ Industrial Relations front like signing of wage agreement, implementation of Voluntary Retirement Scheme etc.
13. Sale of material nature, of investments, subsidiaries, assets, which is not in normal course of business.
14. Quarterly details of foreign exchange exposures and the steps taken by management to limit the risks of adverse exchange rate movement, if material.
15. Non-compliance of any regulatory, statutory nature or listing requirements and shareholders service such as non-payment of dividend, delay in share transfer etc.

Section 5: The way forward

The next few years will see a flurry of activity on the corporate governance front. While to a certain extent, this activity will be driven by more stringent regulations, to a greater extent, the momentum will come from the forces of competition, and demand for low-cost capital.

First, and most important, is the force of competition. With the dismantling of licenses and controls, reduction of import tariffs and quotas, virtual elimination of public sector reservations, and a much more liberalized regime for foreign direct and portfolio investments, Indian companies have faced more competition in the second half of the 1990s than they did since independence. Competition has forced companies to drastically restructure their ways of doing business. Under utilized assets are being sold, capital is being utilized like never before, and companies are focusing on the top and bottom line with a hitherto unknown degree of intensity. Moreover, while there have been losers in liberalization, competition has led to greater overall profits. Thus, the aggregate financial impact of competition has been positive — the more so for those who went through the pains of restructuring in the relatively early days of liberalization. And there is every indication that while many companies will fall by the wayside, many more will earn greater profits than before.

Second, there has been a great churning taking place in corporate India. Many companies and business groups that were on the top of the pecking order in 1991 have been relegated to much lower positions. Simultaneously, new aggressive companies have clawed their way to the top. By and large, these are firms managed by relatively, modern, outward-oriented professionals who place a great deal of value on corporate governance and transparency — if not for themselves, then as instruments for facilitating access to international and domestic capital. Therefore, they are more than willing to have professional boards and voluntarily follow disclosure standards that measure up to the best in the world.

Third, despite high and low cycles of stock prices, there has been a phenomenal growth in market capitalization. The market capitalization of companies listed on the BSE on 1 April 1991 was Rs.658 billion, or \$41 billion at the prevailing exchange rate. On 1 April 2003, market cap of all BSE companies stood at Rs.5,461 billion, or \$116 billion at current exchange rates. This growth has triggered a fundamental change in mindset from the earlier one of appropriating larger slices of a small pie, to doing all that is needed to let the pie grow. Creating and distributing wealth has become a more popular maxim than ever before — more so when the maxim is seen to be validated by growing market cap.

Fourth, one cannot exaggerate the impact of well-focused, well-researched portfolio investors (both domestic and foreign). These investors have steadily raised their demands for better corporate governance, more transparency and greater disclosure. And given their clout in the secondary market — they account for over 50 per cent of the average daily volume of trade — portfolio investors have voted with their feet. Over the last two

years, they have systematically increased their exposure in well-governed firms at the expense of poorly run ones.

Fifth, India has a strong financial press, which will get stronger with the years. In the last five years, the press and financial analysts have induced a level of disclosure that was inconceivable a decade ago. This will increase and force companies to become more transparent—not just in their financial statements but also in matters relating to internal governance.

Sixth, despite shortcomings in Indian bankruptcy provisions, neither banks nor financial institutions (FIs) will continue to support management irrespective of performance. Already, the more aggressive and market oriented FIs have started converting some of their outstanding debt to equity, and setting up mergers and acquisition subsidiaries to sell their shares in under-performing companies to more dynamic entrepreneurs and managerial groups. This will intensify over time, especially with the advent of universal banking.

Seventh, Indian corporations have appreciated the fact that good corporate governance and internationally accepted standards of accounting and disclosure can help them to access the US capital markets. Until 1998, this premise existed only in theory. It changed with Infosys making its highly successful Nasdaq issue in March 1998. This has been followed by 10 more US depository issues. This trend has had two major beneficial effects. First, it has shown that good governance pays off, and allows companies to access the world's largest capital market. Second, it has demonstrated that good corporate governance and disclosures are not difficult to implement — and that Indian companies can do all that is needed to satisfy US investors and the SEC. The message is now clear: it makes good business sense to be a transparent, well-governed company incorporating internationally acceptable accounting standards.

Finally, prospects of future policy changes towards capital account convertibility creates its own challenges. With capital account convertibility an Indian investor may seriously consider putting his funds in an Indian company or a foreign mutual or pension fund. The choice before the investor is likely to further propel good corporate governance. Thankfully, many Indian companies have already seen the writing on the wall and are concentrating on good corporate governance practices. -

Section 6: The National Foundation for Corporate Governance

There is no doubt that once the government and the regulators establish an efficient and effective regulatory framework for corporations to function in, the market would push these corporations to raise the bar constantly. There is also no doubt that India is progressing towards the inevitability of market-driven corporate governance practices. The corporate governance ratings introduced by some rating agencies in India, and the willingness showed by many companies to volunteer for these is a case in point.

In the midst of this transition, the NFCG will play an important role. The Foundation, on a continuous basis, would collaborate with the regulators and concerned authorities to develop regulations which are in line with the dynamics of the emerging business environment and at the same time help corporations implement these regulations in letter and spirit. This would, however, not be a two-pronged approach but a multi-pronged one and would include:

- Creating awareness on the importance of implementing good corporate governance practices both at the level of individual corporations and for the economy as a whole. The foundation would provide a platform for quality discussions and debates amongst academicians, policy makers, professionals and corporate leaders through workshops, conferences, meetings and seminars.
- Encouraging research capability in the area of corporate governance in the country and providing key inputs for developing laws and regulations which meet the twin objectives of maximizing wealth creation and fair distribution of this wealth.
- Working with the regulatory authorities at multiple levels to improve implementation and enforcement of various laws related to corporate governance
- In close coordination with the private sector, work to instil a commitment to corporate governance reforms and facilitate the development of a corporate governance culture
- Cultivating international linkages and maintaining the evolution towards convergence with international standards and practices for accounting, audit and non-financial disclosure.
- Setting up of 'National Centres for Corporate Governance' across the country, which would provide quality training to Directors and aim to have global recognition and acceptance.

In addition, the NFCG proposes to focus on the following initiatives:

- Encourage Corporate Governance cooperation in South Asia particularly relating to SAARC countries;
- Hold seminars in collaboration with World Bank and Asian Development Bank on Corporate Governance Audit;
- Explore the desirability and possibility of including Whistle Blowers' Policy as an essential feature of Corporate Governance;

- Work out feasibility of Corporate Governance guidelines for large institutional investors;
- Institute an annual award for the best Centre for Corporate Governance
- Work out the modalities for setting up of a database of independent directors with wider interactions with eminent groups, persons and societies.

These initiatives will be carried out after extensive consultations with concerned stakeholders. All these initiatives will be totally non-mandatory in nature. It will be entirely upto individual companies and institutional investors to decide whether they want to adopt the model whistle blowers' policy or the model corporate governance policies suggested by the NFCG. Similarly, the participation in the corporate governance audit, too, will be optional.

The NFCG would also like to play a role in promoting corporate governance throughout South Asia. It will explore the possibility of linkages and cooperation with other countries in the SAARC region and seek to establish 'National Centres for Corporate Governance' as centres for excellence in the entire region. Once these centres become fully functional they could provide training to persons from South Asia Region in the area of corporate governance.

Appendix I: Clause 49 of the listing agreement

I. Board of Directors

A. The company agrees that the board of directors of the company shall have an optimum combination of executive and non-executive directors with not less than fifty percent of the board of directors comprising of non-executive directors. The number of independent directors would depend whether the Chairman is executive or non-executive. In case of a non-executive chairman, at least one-third of board should comprise of independent directors and in case of an executive chairman, at least half of board should comprise of independent directors.

Explanation: For the purpose of this clause the expression ‘independent directors’ means directors who apart from receiving director’s remuneration, do not have any other material pecuniary relationship or transactions with the company, its promoters, its management or its subsidiaries, which in judgement of the board may affect independence of judgement of the director.

B. The company agrees that all pecuniary relationship or transactions of the non-executive directors viz-a-viz. the company should be disclosed in the Annual Report.

II. Audit Committee

A. The company agrees that a qualified and independent audit committee shall be set up and that:

The audit committee shall have minimum three members, all being non-executive directors, with the majority of them being independent, and with at least one director having financial and accounting knowledge;

- The chairman of the committee shall be an independent director;
- The chairman shall be present at Annual General Meeting to answer shareholder queries;
- The audit committee should invite such of the executives, as it considers appropriate (and particularly the head of the finance function) to be present at the meetings of the committee, but on occasions it may also meet without the presence of any executives of the company. The finance director, head of internal audit and when required, a representative of the external auditor shall be present as invitees for the meetings of the audit committee;
- The Company Secretary shall act as the secretary to the committee.

B. The audit committee shall meet at least thrice a year. One meeting shall be held before finalization of annual accounts and one every six months. The quorum shall be either two members or one third of the members of the audit committee, whichever is higher and minimum of two independent directors.

- C. The audit committee shall have powers which should include the following :
- To investigate any activity within its terms of reference.
 - To seek information from any employee.
 - To obtain outside legal or other professional advice.
 - To secure attendance of outsiders with relevant expertise, if it considers necessary.
- D. The company agrees that the role of the audit committee shall include the following.
- Oversight of the company's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.
 - Recommending the appointment and removal of external auditor, fixation of audit fee and also approval for payment for any other services.
 - Reviewing with management the annual financial statements before submission to the board, focusing primarily on;
 - Any changes in accounting policies and practices.
 - Major accounting entries based on exercise of judgment by management.
 - Qualifications in draft audit report.
 - Significant adjustments arising out of audit.
 - The going concern assumption.
 - Compliance with accounting standards.
 - Compliance with stock exchange and legal requirements concerning financial statements
 - Any related party transactions i.e. transactions of the company of material nature, with promoters or the management, their subsidiaries or relatives etc. that may have potential conflict with the interests of company at large.
 - Reviewing with the management, external and internal auditors, the adequacy of internal control systems.
 - Reviewing the adequacy of internal audit function, including the structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure coverage and frequency of internal audit.
 - Discussion with internal auditors any significant findings and follow up there on.
 - Reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the board.
 - Discussion with external auditors before the audit commences nature and scope of audit as well as have post-audit discussion to ascertain any area of concern.
 - Reviewing the company's financial and risk management policies.
 - To look into the reasons for substantial defaults in the payment to the depositors, debenture holders, shareholders (in case of non payment of declared dividends) and creditors.

- E. If the company has set up an audit committee pursuant to provision of the Companies Act, the company agrees that the said audit committee shall have such additional functions / features as is contained in the Listing Agreement.

III. Remuneration of Directors

- A. The company agrees that the remuneration of non-executive directors shall be decided by the board of directors.
- B. The company further agrees that the following disclosures on the remuneration of directors shall be made in the section on the corporate governance of the annual report.
- All elements of remuneration package of all the directors i.e. salary, benefits, bonuses, stock options, pension etc.
 - Details of fixed component and performance linked incentives, along with the performance criteria.
 - Service contracts, notice period, severance fees.
 - Stock option details, if any – and whether issued at a discount as well as the period over which accrued and over which exercisable.

IV. Board Procedure

- A. The company agrees that the board meeting shall be held at least four times a year, with a maximum time gap of four months between any two meetings. The minimum information to be made available to the board is given in Annexure-I.
- B. The company further agrees that a director shall not 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. Furthermore it should be a mandatory annual requirement for every director to inform the company about the committee positions he occupies in other companies and notify changes as and when they take place.

V. Management

- A. The company agrees that as part of the directors' report or as an addition there to, a Management Discussion and Analysis report should form part of the annual report to the shareholders. This Management Discussion & Analysis should include discussion on the following matters within the limits set by the company's competitive position:
- Industry structure and developments.
 - Opportunities and Threats.
 - Segment-wise or product-wise performance.
 - Outlook
 - Risks and concerns.
 - Internal control systems and their adequacy.

- Discussion on financial performance with respect to operational performance.
- Material developments in Human Resources / Industrial Relations front, including number of people employed.

B. Disclosures must be made by the management to the board relating to all material financial and commercial transactions, where they have personal interest, that may have a potential conflict with the interest of the company at large (for e.g. dealing in company shares, commercial dealings with bodies, which have shareholding of management and their relatives etc.)

VI. Shareholders

A. The company agrees that in case of the appointment of a new director or re-appointment of a director the shareholders must be provided with the following information:

- A brief resume of the director;
- Nature of his expertise in specific functional areas ; and
- Names of companies in which the person also holds the directorship and the membership of Committees of the board.

B. The company further agrees that information like quarterly results, presentation made by companies to analysts shall be put on company's web-site, or shall be sent in such a form so as to enable the stock exchange on which the company is listed to put it on its own web-site.

C. The company further agrees that a board committee under the chairmanship of a non-executive director shall be formed to specifically look into the redressing of shareholder and investors complaints like transfer of shares, non-receipt of balance sheet, non-receipt of declared dividends etc. This Committee shall be designated as 'Shareholders/Investors Grievance Committee'.

D. The company further agrees that to expedite the process of share transfers the board of the company shall delegate the power of share transfer to an officer or a committee or to the registrar and share transfer agents. The delegated authority shall attend to share transfer formalities at least once in a fortnight.

VII. Report on Corporate Governance

The company agrees that there shall be a separate section on Corporate Governance in the annual reports of company, with a detailed compliance report on Corporate Governance. Non compliance of any mandatory requirement i.e. which is part of the listing agreement with reasons there of and the extent to which the non-mandatory requirements have been adopted should be specifically highlighted. The suggested list of items to be included in this report is given in Annexure-2 and list of non-mandatory requirements is given in Annexure-3.

VIII Compliance

The company agrees that it shall obtain a certificate from the auditors of the company regarding compliance of conditions of corporate governance as stipulated in this clause and annexe the certificate with the directors' report, which is sent annually to all the shareholders of the company. The same certificate shall also be sent to the Stock Exchanges along with the annual returns filed by the company.

Schedule of Implementation :

The above amendments to the listing agreement have to be implemented as per schedule of implementation given below:

- By all entities seeking listing for the first time, at the time of listing.
- Within financial year 2000-2001, but not later than March 31, 2001 by all entities, which are included either in Group 'A' of the BSE or in S&P CNX Nifty index as on January 1, 2000. However to comply with the recommendations, these companies may have to begin the process of implementation as early as possible.
- Within financial year 2001-2002, but not later than March 31, 2002 by all the entities which are presently listed, with paid up share capital of Rs. 100 million and above, or networth of Rs 250 million or more any time in the history of the company.
- Within financial year 2002-2003, but not later than March 31, 2003 by all the entities which are presently listed, with paid up share capital of Rs.30 million and above
- As regards the non-mandatory requirement given in Annexure-3, they shall be implemented as per the discretion of the company. However, the disclosures of the adoption/non-adoption of the non-mandatory requirements shall be made in the section on corporate governance of the Annual Report.

Annexure 1

Information to be placed before board of directors

- Annual operating plans and budgets and any updates.
- Capital budgets and any updates.
- Quarterly results for the company and its operating divisions or business segments.
- Minutes of meetings of audit committee and other committees of the board.
- The information on recruitment and remuneration of senior officers just below the board level, including appointment or removal of Chief Financial Officer and the Company Secretary.
- Show cause, demand, prosecution notices and penalty notices which are materially important
- Fatal or serious accidents, dangerous occurrences, any material effluent or pollution problems.
- Any material default in financial obligations to and by the company, or substantial non-payment for goods sold by the company.
- Any issue, which involves possible public or product liability claims of substantial nature, including any judgement or order which, may have passed strictures on the conduct of the company or taken an adverse view regarding another enterprise that can have negative implications on the company.
- Details of any joint venture or collaboration agreement.
- Transactions that involve substantial payment towards goodwill, brand equity, or intellectual property.
- Significant labor problems and their proposed solutions. Any significant development in Human Resources/ Industrial Relations front like signing of wage agreement, implementation of Voluntary Retirement Scheme etc.
- Sale of material nature, of investments, subsidiaries, assets, which is not in normal course of business.
- Quarterly details of foreign exchange exposures and the steps taken by management to limit the risks of adverse exchange rate movement, if material.
- Non-compliance of any regulatory, statutory nature or listing requirements and shareholders service such as non-payment of dividend, delay in share transfer etc.

Annexure 2

Suggested List Of Items To Be Included In The Report On Corporate Governance In The Annual Report Of Companies

1. A brief statement on company's philosophy on code of governance.

2. Board of Directors:

- Composition and category of directors for example promoter, executive, non-executive, independent non-executive, nominee director, which institution represented as Lender or as equity investor.
- Attendance of each director at the BoD meetings and the last AGM.
- Number of other BoDs or Board Committees he/she is a member or Chairperson of.
- Number of BoD meetings held, dates on which held.

3. Audit Committee

- Brief description of terms of reference
- Composition, name of members and Chairperson
- Meetings and attendance during the year

4. Remuneration Committee

- Brief description of terms of reference
- Composition, name of members and Chairperson
- Attendance during the year
- Remuneration policy
- Details of remuneration to all the directors, as per format in main report.

5. Shareholders Committee

- Name of non-executive director heading the committee
- Name and designation of compliance officer
- Number of shareholders complaints received so far
- Number not solved to the satisfaction of shareholders
- Number of pending share transfers

6. General Body meetings

- Location and time, where last three AGMs held.
- Whether special resolutions
- Were put through postal ballot last year, details of voting pattern.
- Person who conducted the postal ballot exercise

- Are proposed to be conducted through postal ballot
- Procedure for postal ballot

7. Disclosures

- Disclosures on materially significant related party transactions i.e. transactions of the company of material nature, with its promoters, the directors or the management, their subsidiaries or relatives etc. that may have potential conflict with the interests of company at large.
- Details of non-compliance by the company, penalties, strictures imposed on the company by Stock Exchange or SEBI or any statutory authority, on any matter related to capital markets, during the last three years.

8. Means of communication

- Half-yearly report sent to each household of shareholders.
- Quarterly results
- Which newspapers normally published in.
- Any website, where displayed
- Whether it also displays official news releases; and
- The presentations made to institutional investors or to the analysts.
- Whether MD&A is a part of annual report or not.

9. General Shareholder information

- AGM : Date, time and venue
- Financial Calendar
- Date of Book closure
- Dividend Payment Date
- Listing on Stock Exchanges
- Stock Code
- Market Price Data : High., Low during each month in last financial year
- Performance in comparison to broad-based indices such as BSE Sensex, CRISIL index etc.
- Registrar and Transfer Agents
- Share Transfer System
- Distribution of shareholding
- Dematerialization of shares and liquidity
- Outstanding GDRs/ADRs/Warrants or any Convertible instruments, conversion date and likely impact on equity
- Plant Locations
- Address for correspondence

Annexure – 3

Non-Mandatory Requirements

(a) Chairman of the Board

A non-executive Chairman should be entitled to maintain a Chairman's office at the company's expense and also allowed reimbursement of expenses incurred in performance of his duties.

(b) Remuneration Committee

- The board should set up a remuneration committee to determine on their behalf and on behalf of the shareholders with agreed terms of reference, the company's policy on specific remuneration packages for executive directors including pension rights and any compensation payment.
- To avoid conflicts of interest, the remuneration committee, which would determine the remuneration packages of the executive directors should comprise of at least three directors, all of whom should be non-executive directors, the chairman of committee being an independent director.
- All the members of the remuneration committee should be present at the meeting.
- The Chairman of the remuneration committee should be present at the Annual General Meeting, to answer the shareholder queries. However, it would be up to the Chairman to decide who should answer the queries.

(c) Shareholder Rights

The half-yearly declaration of financial performance including summary of the significant events in last six-months, should be sent to each household of shareholders.

(d) Postal Ballot

Currently, although the formality of holding the general meeting is gone through, in actual practice only a small fraction of the shareholders of that company do or can really participate therein. This virtually makes the concept of corporate democracy illusory. It is imperative that this situation which has lasted too long needs an early correction. In this context, for shareholders who are unable to attend the meetings, there should be a requirement which will enable them to vote by postal ballot for key decisions. Some of the critical matters which should be decided by postal ballot are given below:

- Matters relating to alteration in the memorandum of association of the company like changes in name, objects, address of registered office etc;
- Sale of whole or substantially the whole of the undertaking;
- Sale of investments in the companies, where the shareholding or the voting rights of the company exceeds 25%;
- Making a further issue of shares through preferential allotment or private placement basis;
- Corporate restructuring;
- Entering a new business area not germane to the existing business of the company;
- Variation in rights attached to class of securities;

Appendix II: Major recommendations of the Naresh Chandra Committee on Corporate Governance

Auditor-Company relationship

- Prohibition of any direct financial interest in the audit client by the audit firm, its partners or members of the engagement team as well as their 'direct relatives'.
- Prohibition of receiving any loans and/or guarantees from or on behalf of the audit client by the audit firm, its partners or any member of the engagement team and their 'direct relatives'.
- Prohibition of any business relationship with the audit client by the auditing firm, its partners or any member of the engagement team and their 'direct relatives'.
- Prohibition of personal relationships, which would exclude any partner of the audit firm or member of the engagement team being a 'relative' of any of key officers of the client company, i.e. any whole-time director, CEO, CFO, Company Secretary, senior manager belonging to the top two managerial levels of the company, and the officer who is in default
- Prohibition of service or cooling off period, under which any partner or member of the engagement team of an audit firm who wants to join an audit client, or any key officer of the client company wanting to join the audit firm, would only be allowed to do so after two years from the time they were involved in the preparation of accounts and audit of that client.
- Prohibition of undue dependence on an audit client. So that no audit firm is unduly dependent on an audit client, the fees received from any one client and its subsidiaries and affiliates, all together, should not exceed 25 per cent of the total revenues of the audit firm.

Prohibition on audit firms to provide the following non-audit services

- Accounting and bookkeeping services, related to the accounting records or financial statements of the audit client.
- Internal audit services.
- Financial information systems design and implementation, including services related to IT systems for preparing financial or management accounts and information flows of a company.
- Actuarial services.
- Broker, dealer, investment adviser or investment banking services.
- Outsourced financial services.
- Management functions, including the provision of temporary staff to audit clients.
- Any form of staff recruitment, and particularly hiring of senior management staff for the audit client.
- Valuation services and fairness opinion.

Compulsory Audit Partner Rotation

- The partners and at least 50 per cent of the engagement team (excluding article clerks and trainees) responsible for the audit of a listed company, or companies whose paid-up capital and free reserves exceeds Rs.100 million, or companies whose turnover exceeds Rs.500 million, should be rotated every five years.

Auditor's disclosure of qualifications and consequent action

- Qualifications to accounts, if any, must be listed in full in plain English, and adequately highlighted, section of the auditor's report to the shareholders.
- In case of a qualified auditor's report, the audit firm may read out the qualifications, with explanations, to shareholders in the company's annual general meeting.
- It should also be mandatory for the audit firm to separately send a copy of the qualified report to the ROC, the SEBI and the principal stock exchange (for listed companies), about the qualifications, with a copy of this letter being sent to the management of the company. This may require suitable amendments to the Companies Act, and corresponding changes in The Chartered Accountants Act.

Management's certification in the event of auditor's replacement

- Section 225 of the Companies Act needs to be amended to require a special resolution of shareholders, in case an auditor, while being eligible to re-appointment, is sought to be replaced. The explanatory statement accompanying such a special resolution must disclose the management's reasons for such a replacement, on which the outgoing auditor shall have the right to comment.

Appointment of auditors

- The Audit Committee of the board of directors shall be the first point of reference regarding the appointment of auditors. To discharge this fiduciary responsibility, the Audit Committee shall discuss the annual work programme with the auditor and recommend to the board, with reasons, either the appointment/re-appointment or removal of the external auditor, along with the annual audit remuneration.

CEO and CFO certification of annual audited accounts

- For all listed companies as well as public limited companies whose paid-up capital and free reserves exceeds Rs.100 million, or turnover exceeds Rs.500 million, there should be a certification by the CEO (either the Executive Chairman or the Managing Director) and the CFO (whole-time Finance Director or otherwise) which should state that, to the best of their knowledge and belief:
- They, the signing officers, have reviewed the balance sheet and profit and loss account and all its schedules and notes on accounts, as well as the cash flow statements and the Directors' Report.

- These statements do not contain any material untrue statement or omit any material fact nor do they contain statements that might be misleading.
- These statements together represent a true and fair picture of the financial and operational state of the company, and are in compliance with the existing accounting standards and/or applicable laws/regulations.
- They, the signing officers, are responsible for establishing and maintaining internal controls which have been designed to ensure that all material information is periodically made known to them; and have evaluated the effectiveness of internal control systems of the company.
- They, the signing officers, have disclosed to the auditors as well as the Audit Committee deficiencies in the design or operation of internal controls, if any, and what they have done or propose to do to rectify these deficiencies.
- They, the signing officers, have also disclosed to the auditors as well as the Audit Committee instances of significant fraud, if any, that involves management or employees having a significant role in the company's internal control systems.
- They, the signing officers, have indicated to the auditors, the Audit Committee and in the notes on accounts, whether or not there were significant changes in internal control and/or of accounting policies during the year under review.
- In the event of any materially significant misstatements or omissions, the signing officers will return to the company that part of any bonus or incentive- or equity-based compensation which was inflated on account of such errors, as decided by the Audit Committee.

Definition of an independent director

An independent director of a company is a non-executive director who:

1. Apart from receiving director's remuneration, does not have any material pecuniary relationships or transactions with the company, its promoters, its senior management or its holding company, its subsidiaries and associated companies;
2. Is not related to promoters or management at the board level, or one level below the board (spouse and dependent, parents, children or siblings);
3. Has not been an executive of the company in the last three years;
4. Is not a partner or an executive of the statutory auditing firm, the internal audit firm that are associated with the company, and has not been a partner or an executive of any such firm for the last three years. This will also apply to legal firm(s) and consulting firm(s) that have a material association with the entity.
5. Is not a significant supplier, vendor or customer of the company;
6. Is not a substantial shareholder of the company, i.e. owning 2 per cent or more of the block of voting shares;
7. Has not been a director, independent or otherwise, of the company for more than three terms of three years each (not exceeding nine years in any case);
 - An employee, executive director or nominee of any bank, financial institution, corporations or trustees of debenture and bond holders, who is normally called a

‘nominee director’ will be excluded from the pool of directors in the determination of the number of independent directors. In other words, such a director will not feature either in the numerator or the denominator.

- Moreover, if an executive in, say, Company X becomes a non-executive director in another Company Y, while another executive of Company Y becomes a non-executive director in Company X, then neither will be treated as an independent director.

Percentage of independent directors

- No less than 50 per cent of the board of directors of any listed company, as well as unlisted public limited companies with a paid-up share capital and free reserves of Rs.100 million and above, or turnover of Rs.500 million and above, should consist of independent directors.

However, the above will not apply to: (1) unlisted public companies, which have no more than 50 shareholders and which are without debt of any kind from the public, banks, or financial institutions, as long as they do not change their character, (2) unlisted subsidiaries of listed companies.

Minimum board size of listed companies

- The minimum board size of all listed companies, as well as unlisted public limited companies with a paid-up share capital and free reserves of Rs.100 million and above, or turnover of Rs.500 million and above should be seven — of which at least four should be independent directors.

However, this will not apply to: (1) unlisted public companies, which have no more than 50 shareholders and which are without debt of any kind from the public, banks, or financial institutions, as long as they do not change their character, (2) unlisted subsidiaries of listed companies.

Disclosure on duration of board meetings / Committee meetings

- The minutes of board meetings and Audit Committee meetings of all listed companies, as well as unlisted public limited companies with a paid-up share capital and free reserves of Rs.100 million and above or turnover of Rs.500 million must disclose the timing and duration of each such meeting, in addition to the date and members in attendance.

Additional disclosure to directors

- In addition to the disclosures specified in Clause 49 under ‘Information to be placed before the board of directors’, all listed companies, as well as unlisted public limited companies with a paid-up share capital and free reserves of Rs.100 million and above, or turnover of Rs.500 million and above, should transmit all press releases and presentation to analysts to all board members. This will further help in keeping independent directors informed of how the company is projecting itself to the general public as well as a body of informed investors

Independent directors on Audit Committees of listed companies

- Audit Committees of all listed companies, as well as unlisted public limited companies with a paid- up share capital and free reserves of Rs.100 million and above, or turnover of Rs.500 million and above, should consist exclusively of independent directors.

However, this will not apply to: (1) unlisted public companies, which have no more than 50 shareholders and which are without debt of any kind from the public, banks, or financial institutions, as long as they do not change their character, (2) unlisted subsidiaries of listed companies.

Tele-conferencing and video conferencing

- If a director cannot be physically present but wants to participate in the proceedings of the board and its committees, then a minuted and signed proceedings of a tele-conference or video conference should constitute proof of his or her participation. Accordingly, this should be treated as presence in the meeting(s). However, minutes of all such meetings should be signed and confirmed by the director/s who has/have attended the meeting through video conferencing

Audit Committee charter

- In addition to disclosing the names of members of the Audit Committee and the dates and frequency of meetings, the Chairman of the Audit Committee must annually certify whether and to what extent each of the functions listed in the Audit Committee Charter were discharged in the course of the year. This will serve as the Committee’s ‘action taken report’ to the shareholders.
- This disclosure shall also give a succinct but accurate report of the tasks performed by the Audit Committee, which would include, among others, the Audit Committee’s views on the adequacy of internal control systems, perceptions of risks and, in the event of any qualifications, why the Audit Committee accepted and recommended the financial statements with qualifications. The statement should also certify whether the Audit Committee met with the statutory and internal auditors of the company without the presence of management, and whether such meetings revealed materially significant issues or risks.

Remuneration of non-executive directors

- The statutory limit on sitting fees should be reviewed, although ideally it should be a matter to be resolved between the management and the shareholders.

In addition, loss-making companies should be permitted by the Department of Company Affairs to pay special fees to any independent director, subject to reasonable caps, in order to attract the best restructuring and strategic talent to the boards of such companies.

Appendix III: Recommendations of the Naryana Murthy Committee on Corporate Governance

Audit committee

Audit committees of publicly listed companies should be required to review the following information mandatorily:

- Financial statements and draft audit report, including quarterly / half-yearly financial information;
- Management discussion and analysis of financial condition and results of operations;
- Reports relating to compliance with laws and to risk management; Management letters / letters of internal control weaknesses issued by statutory internal auditors; and Records of related party transactions.
- All audit committee members should be “financially literate” and at least one member should have accounting or related financial management expertise.

Explanation 1 – The term “financially literate” means the ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows.

Explanation 2 – A member will be considered to have accounting or related financial management expertise if he or she possesses experience in finance or accounting, or requisite professional certification in accounting, or any other comparable experience or background which results in the individual’s financial sophistication, including being or having been a chief executive officer, chief financial officer, or other senior officer with financial oversight responsibilities.

Audit reports and audit qualifications

In case a company has followed a treatment different from that prescribed in an accounting standard, management should justify why they believe such alternative treatment is more representative of the underlying business transaction. Management should also clearly explain the alternative accounting treatment in the footnotes to the financial statements.

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A statement of all transactions with related parties including their bases should be placed before the independent audit committee for formal approval / ratification. If any

transaction is not on an arm's length basis, management should provide an explanation to the audit committee justifying the same.

The term "related party" shall have the same meaning as contained in Accounting Standard 18, Related Party Transactions, issued by the Institute of Chartered Accountants of India.

Risk management

Procedures should be in place to inform board members about the risk assessment and minimization procedures. These procedures should be periodically reviewed to ensure that executive management controls risk through means of a properly defined framework.

Management should place a report before the entire Board of directors every quarter documenting the business risks faced by the company, measures to address and minimize such risks, and any limitations to the risk taking capacity of the corporation. The Board should formally approve this document.

Proceeds from initial public offerings ("IPO")

Companies raising money through an Initial Public Offering ("IPO") should disclose to the Audit Committee, the uses / applications of funds by major category (capital expenditure, sales and marketing, working capital, etc), on a quarterly basis. On an annual basis, the company shall prepare a statement of funds utilised for purposes other than those stated in the offer document/prospectus. The independent auditors of the company should certify this statement. The audit committee should make appropriate recommendations to the Board to take up steps in this matter.

Code of conduct

It should be obligatory for the Board of a company to lay down the code of conduct for all Board members and senior management of a company. This code of conduct shall be posted on the website of the company.

All Board members and senior management personnel shall affirm compliance with the code on an annual basis. The annual report of the company shall contain a declaration to this effect signed off by the CEO and COO.

Explanation – For this purpose, the term "senior management" shall mean personnel of the company who are members of its management / operating council (i.e. core management team excluding Board of directors). Normally, this would comprise all members of management one level below the executive directors.

Nominee directors

There shall be no nominee directors.

Where an institution wishes to appoint a director on the Board, such appointment should be made by the shareholders.

An institutional director, so appointed, shall have the same responsibilities and shall be subject to the same liabilities as any other director.

Nominee of the Government on public sector companies shall be similarly elected and shall be subject to the same responsibilities and liabilities as other directors.

Non-executive director compensation

All compensation paid to non-executive directors may be fixed by the Board of Directors and should be approved by shareholders in general meeting. Limits should be set for the maximum number of stock options that can be granted to non-executive directors in any financial year and in aggregate. The stock options granted to the non-executive directors shall vest after a period of at least one year from the date such non-executive directors have retired from the Board of the Company. Companies should publish their compensation philosophy and statement of entitled compensation in respect of non-executive directors in their annual report.

Alternatively, this may be put up on the company's website and reference drawn there to in the annual report. Companies should disclose on an annual basis, details of shares held by non-executive directors, including on an "if-converted" basis. Non-executive directors should be required to disclose their stock holding (both own or held by / for other persons on a beneficial basis) in the listed company in which they are proposed to be appointed as directors, prior to their appointment. These details should accompany their notice of appointment.

Independent Directors

The term "independent director" is defined as a non-executive director of the company who:

- Apart from receiving director remuneration, does not have any material pecuniary relationships or transactions with the company, its promoters, its senior management its holding company, its subsidiaries and associated companies;
- Is not related to promoters or management at the board level or at one level below the board;
- Has not been an executive of the company in the immediately preceding three financial years;
- Is not a partner or an executive of the statutory audit firm or the internal audit firm that is associated with the company, and has not been a partner or an executive of any such firm for the last three years.

- This will also apply to legal firm(s) and consulting firm(s) that have a material association with the entity, is not a supplier, service provider or customer of the company, and include lessor-lessee type relationships; and
- Is not a substantial shareholder of the company, i.e. owning two percent or more of the block of voting shares.

The considerations as regards remuneration paid to an independent director shall be the same as those applied to a non-executive director.

Whistle blower policy

Personnel who observe an unethical or improper practice (not necessarily a violation of law) should be able to approach the audit committee without necessarily informing their supervisors. Companies shall take measures to ensure that this right of access is communicated to all employees through means of internal circulars, etc. The employment and other personnel policies of the company shall contain provisions protecting “whistle blowers” from unfair termination and other unfair prejudicial employment practices.

Companies shall annually affirm that they have not denied any personnel access to the audit committee of the company (in respect of matters involving alleged misconduct) and that they have provided protection to “whistle blowers” from unfair termination and other unfair or prejudicial employment practices.

The appointment, removal and terms of remuneration of the chief internal auditor must be subject to review by the Audit Committee. Such affirmation shall form a part of the Board report on Corporate Governance that is required to be prepared and submitted together with the annual report.

Subsidiary Companies

The provisions relating to the composition of the Board of directors of the holding company should be made applicable to the composition of the Board of directors of subsidiary companies.

At least one independent director on the Board of directors of the parent company shall be a director on the Board of directors of the subsidiary company. The Audit Committee of the parent company shall also review the financial statements, in particular the investments made by the subsidiary company. The minutes of the Board meetings of the subsidiary company shall be placed for review at the Board meeting of the parent company. The Board report of the parent company should state that they have reviewed the affairs of the subsidiary company also.

Analyst Reports

SEBI should make rules for the following:

- (a) Disclosure in the report issued by a security analyst whether the company that is being written about is a client of the analyst's employer or an associate of the analyst's employer, and the nature of services rendered to such company, if any; and
- (b) Disclosure in the report issued by a security analyst whether the analyst or the analyst's employer or an associate of the analyst's employer hold or held (in the 12 months immediately preceding the date of the report) or intend to hold any debt or equity instrument in the issuer company that is the subject matter of the report of the analyst.