Indian Institute of Corporate Affairs

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A PRIMER ON CORPORATE GOVERNANCE

Partners in Knowledge, Governance, Transformation.

From the DG & CEO

Dear Reader,

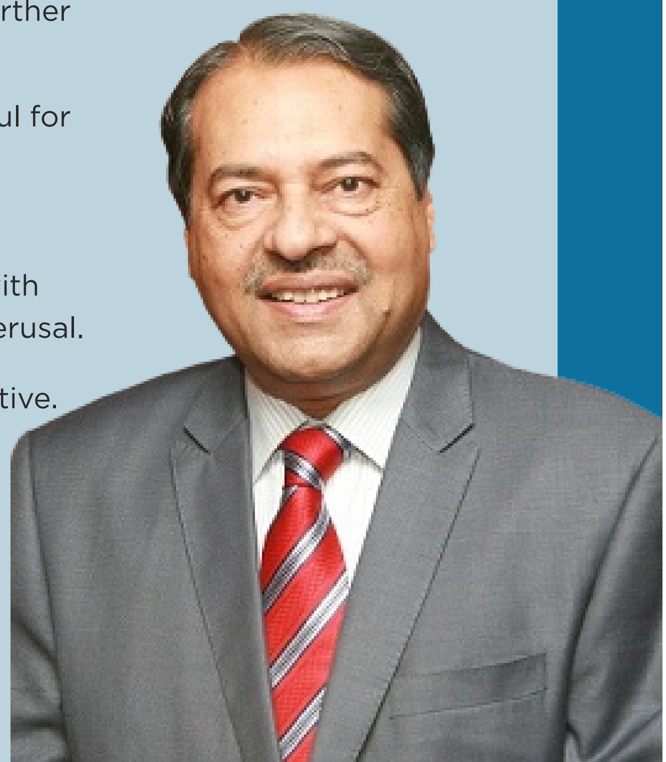
Corporate Governance is a terminology whose ambit is so vast that it takes some grappling with to execute in actual terms. It encompasses every aspect of corporate function and is both a system and a vision. The term has unfortunately however, been used with scant understanding and a great deal of misplaced enthusiasm over the last few decades. The need of the industry at the moment is to come to terms with the standards set in global markets and to bring India Inc up to speed with these benchmarks.

The New Companies Act 2013 has clearly defined the role of Corporate Governance and placed it in the centre of the agenda for business growth. The role of the boardroom, the responsibilities of directors, the significance of independent directors, the expectations of industry and the standards of community and civil society have all been clearly enunciated and must be met.

The School of Corporate Law in the IICA continues its crusade for the empowerment and engagement of corporate India in the national agenda for sustainable development, of which business responsibility is an integral part. It is in this context that this primer on Corporate Governance has been prepared by the School, so that the nuances of Corporate Governance and the resultant responsibilities that devolve upon businesses may be further clarified in practical terms of corporate function.

It is my belief that this primer will be welcome and useful for all those involved in the sphere of business - corporate houses, independent practitioners, scholars and academicians and research students alike. The unique perspective that IICA provides will enrich the content with overtones that are not commonly available for public perusal.

I wish the School of Corporate Law success in this initiative.



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A Primer on Corporate Governance

Understanding a Corporation

Corporate governance (CG), as the name signals, is an integral and indispensable constituent of the 'corporate' form of organization. Therefore, before attempting to understand corporate governance, it is necessary to understand a corporate structure.

Unique Characteristics of a Corporate Form of Organization

Distinct Legal Entity

- A corporate body created by the law is an entity which is legally distinct from individuals (who put their share corpus in it) and has perpetual existence. It has the capacity to own assets, act on its own and bear liability for its actions.

Separation of Ownership and Management

- There is a distinction between those who have ownership of the company and those who control its affairs. The management runs the operations of the company without being individually responsible for providing finance.

Limited Liabilities of the Members

- Limited liability with respect to share ownership confers an attractive option for risk-averse investors who want to be part of the organization through their investment in share capital.

Ease of Transferability of Ownership

- A shareholder can easily pass the risk of ownership to others if he perceives that stocks of the company may lose value.

Corporate Governance : Concept & Problems

The underlying need of corporate governance dates back to the emergence of companies.

Adam Smith was the first to one to highlight governance problems in family controlled companies because of trustworthiness of managers cum directors in looking after all the shareholder's money.

Companies have grown both in their size and productivity due to their ability to access vast quantities of investment capital from the public, and by employing professional managers to manage the business. In companies that are large both in terms of size and complexity, shareholders face certain issues in management:

- Shareholders of a public company are widely dispersed
- Shareholders are unable to participate in day to day affairs due to the size and scale of the company
- Shareholders often do not posses the skills and expertise required to deal with complexity of operations
- Shareholders have to rely on the managers, who provide sufficient skills and management expertise
- Shareholders have to provide managerial rights to control the affairs of the company, utilize the assets and provide a return on their investment.

The separation of ownership (shareholders) and control (management), particularly in large companies with fragmented ownership, poses governance problems. Investors in public companies face the challengeof ensuring efficient utilization of their funds by managers for creation of wealth. Corporate governance has evolved due to this separation of ownership and management with a view to solving governance problems in the companies.

"The directors of such companies, being managers of other people's money rather than their own, it cannot be expected that they should watch over it with the same anxious vigilance with the partners in the private copartnery watch over their own…. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company."

Adam Smith (1776)

Corporate governance mechanisms are employed to reduce the conflict between those who control the affairs of a company with all those who also have ownership and stake in it.

Definitions of Corporate Governance

The extent and scope of corporate governance is vast and spans multiple disciplines. Due to such pluralism of corporate governance, its definition varies among scholars and researchers according to the perspective that they view the subject with.

Earliest Definition of Corporate Governance

The system by which companies are directed and controlled. The Board of Directors is primarily responsible for governance of the company. The shareholder, on the other hand, is just there to appoint the directors and auditors and assure that a governance structure is in its place in the company.

Cadbury report (1992, para. 2.5)

Definition of Corporate Governance from Different Perspectives

Economic Perspective	A complex set of constraints that shape the ex-post bargaining over the quasi rents generated by the firm. *(Zingales, 1998, p. 499)*
Financial Perspective	The ways in which suppliers of finance to corporations assure themselves of getting a return on their investments *(Shleifer and Vishny, 1997 p. 737)*
Legal Perspective	The rule that sustain and regulate the mode of decision making within the corporation as a mechanism of social choice and in relation to a public interest *(J.E. Parkinson 1993 as cited in Aguilera & Jackson, 2010, p. 489)*
Organizational Perspective	Entire paraphernalia of an organisation's culture, ethos, beliefs, share values and structure that support successful achievement of corporate objectives. *(Keasey & Wright, 1993, p. 4).*
Management Perspective	An immensely desirable (and largely self-imposed) mechanism that facilitates corporate processes by motivating executives to respect the rights and interests of stakeholders and simultaneously making the said stakeholders accountable for the protection and distribution of corporate resources and earnings in the best interests of all. *(Singh et al., 2011 p. 507)*

A Broad and Widely Accepted Definition

Corporate Governance involves a set of relationship between a company's management, its board, its shareholders, and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set and the means of attaining those objectives and monitoring the performance are determined.

(OCED Corporate Governance Principles, 2004, p. 11)

Importance of Corporate Governance

- Adoption of good corporate governance principles and practices improves access to financing for a company as it is considered imperative for investment decisions.
- A company having better corporate governance can have better valuation as investors are willing to pay a higher premium for it.
- It lowers the cost of capital for a company by reducing the risk and thus creating higher company valuation.
- It has significant bearing on a company's ability to allocate resources efficiently and attain long term sustainability.
- It can improve a company's performance through effective management in asset utilization, improved labour guidelines, and other policy improvements.
- Good corporate governance reduces the risk of financial crisis in a country.

Corporate Governance Dimensions and Perspectives

Market based and Network based Corporate Governance System

Features	Shareholder Model Market Oriented (Outsider) System of Corporate Governance	Stakeholder Model Network Oriented (Insider) System of Corporate Governance
Ownership Structure	Dispersed equity ownership, most of the shares are in the hands of dispersed group of individuals and particularly institutional investors	Concentration of ownership with interlocking and pyramidal structure
Countries/ Variations	US and UK, also Canada, Australia, New Zealand and Ireland	German system – commercial banks play a dominant role and a major actor of corporate control . French system - state is dominant shareholder and companies mutually control each other through a web of complex cross holding known as “verrouillage”. Japanese system - ownership and control of corporations is through “Keiretsu” system, where bank and financial companies play a central role.
Control of Corporation	Separation of ownership and control by management	Control of corporation by reciprocal ownership by companies and families
Shareholder /Stakeholder	Recognizes primacy of shareholders in the company	Recognizes the role of all the stakeholder (including employees)
Governance Problem	Conflict between managers and shareholders	Conflict between the firm itself – including, particularly, its owners- and other parties with whom the firm contracts, such as creditors, employees, and customers
Transparency & Disclosure	High transparency and disclosure standards	Low level of transparency and disclosure standards
Finance to Corporations	Preference for equity capital as a means of financing	Preference for debt capital (Bank) as a means of financing, high debt to equity ratio
Strength of Capital Markets	Fully developed and liquid capital market	Comparatively weak and illiquid capital
Legal System	Common law system	Civil law system
Board Structure	Unitary board structure	Predominately dual board structure (unitary structure optional)
Market for Corporate Control	Large and active market for corporate control	Weak market for corporate control
Relationship Orientation	Short term relationship orientation	Long term relationship orientation
Labour Relationship	Ready market for external managerial labour	Strong internal labor market with long term relationship
Engagement with Financers	Active role of institutional investors	Active role of banks
Legal Protection	Strong protection of shareholders in equity market regulation	Comparatively weak protection to shareholders, but strong protection to creditors

Corporate Governance Dimensions and Perspectives

Shareholder Model Market Oriented (Outsider) System of Corporate Governance	Stakeholder Model Network Oriented (Insider) System of Corporate Governance
Weaknesses	
■ Information asymmetry creates an opportunity for managers to involve in insider trading, a customary practice in market centric governance system. ■ Excessive power to mangers provides sufficient incentive to instigate frauds (eg. Enron, Maxwell, etc.) ■ Managers can reward themselves with excessive remuneration, even for non-performance. ■ Short-term economic horizon of investment by shareholders impels managers to take excessive risk and behave myopically that may result in a crisis.	■ Due to culture of reciprocity and long stakeholder consultation, it is averse to risky ventures, professionalism of management and restructuring in the case of discontinuous change. ■ Recurring interference by the state in the governance process, either through its ownership or through regulatory control encumbers efficient functioning of corporations. ■ The ownership concentration and illiquid capital market results in condensation of risk to the bank / state that may result in the collapse of an entire economy in the case of extreme business contraction or crisis.
Corporate Governance Mechanism	
■ Market for corporate control is one of the dominant forms of external market based control mechanism to punish erring or under-performing managers. ■ A board with a majority of independent directors upholds stringent internal decision control over the decision management of executive directors ■ Institutional investors play an active role in monitoring the activities of the managers. ■ Availability of sound managerial labor market in the Anglo-Saxon economies also helps in alleviating the governance problem to a large extent. ■ Long-term incentive based executive remuneration tools like stock-option have been designed as a governance mechanism in market centric economies in direction to persuade managers to think like an owner of the corporation, which may align their interest with shareholders of the corporation.	■ External market mechanism like market for corporate control (through takeovers) or strong disclosures are either weak or absent. ■ The system entrust internal corporate governance mechanisms family, bank and intertwined corporate relations, alliances and cross-holdings through interlocking directorship. ■ The governance model has "relational board structure" that embraces to include the key stakeholders such as labor, lenders, customers and other suppliers, with employee playing a dominant role in board decision making process. The board holds a pluralistic view to safeguard all stakeholder interest. ■ The managers' performance is directly monitored by both the company and the employees (through representation on the board), which prevents them from taking any undue advantage of their position.

Corporate Governance Theories

Agency Theory

Agency theory developed by Jensen and Meckling (1976) is a simple financial model to observe corporate governance problems in corporations.

- Directly applicable to companies with diffuse ownership structures.
- The theory is concerned with understanding the consequences and solutions arising in the corporations, due to the separation of ownership and control.
- In this theory, the financiers of capital (principal) appoint managers (agents) with specialized human capital to look after their funds and generate return on that fund.
- Manager's control of the firm emanates conflict of interest between the principal and the agents. Managers having better access of information than shareholders, and discretion over investment decisions of finance may not be involved in the activities that give credence to shareholder interest.
- Shareholder incurs some agency costs such as monitoring cost, boding cost and the residual loss, to mitigate against these agency problems
- Monitoring cost is borne by the principals to monitor the aberrant behavior of the agents due to divergence of interest. These are the control costs that arise, such as, for remunerating managers and keeping a majority of independent directors on the Board.
- Bonding cost is incurred to align agent interest with that of the principal. This includes cost of information disclosure to the shareholders, and cost of preparing audited financial statements for the company.
- Residual loss arises due to the cost of enforcing contract between management and shareholders.

Stakeholder Theory

Freeman (1984) first made choice of the word “stakeholder” and defined it as “any group of individual who is affected by or can affect the achievement of an organization's objectives”.

- Stakeholder theory, rather than conceiving the corporation as a bundle of assets that only belongs to the shareholders, construe it as the property of all those who contribute their specific resources to it.
- The company is conceived as an institutional arrangement for managing the relationship between all the parties who have a stake in it.
- Identifies the corporate governance problems of a relationship-based system due to absence of stakeholder involvement in the governance process.
- The manager's job is to maintain the support of all of these groups, balancing their interests, while making the organization a place where all stakeholder interests can be maximized over time.
- The theory proponents are in support of providing important stakeholders (such as relationship investors- banks, employees) a direct voice in the governance process.

Corporate Governance Theories

Stewardship Theory

Developed by Donaldson and Davis (1991), it presents an alternative view to the agency theory, disregarding that there is a conflict between managers and shareholders.

- The theory assumes that managers are trustworthy and attach significant value to their reputation.
- Managers are considered to be stewards of the company, with their objective aligned with the interest of the shareholders. Therefore, their behaviour will not deviate from the interest of the organization.
- It highlights that any mechanism to control the behaviour of managers is not good because it lowers the motivation of managers to work towards the goals of the company. It supports a strong relationship between the shareholders and managers.
- The theory shows a preference for an insider dominated board of directors.
- Financial reporting and disclosure are considered important, but only to the extent that confirms the trustworthiness of the managers.
- Market for managers is considered as the most important mechanism under this theory. A manager's reputation controls his behaviour because in the job market for managers, a more trustworthy and reputable manager is considered to have better compensation than others.

Corporate Governance Principles, Codes and Practices

Principles of Corporate Governance

There are six principles of corporate governance recommended by the Organisation of Economic Co-operation and Development (OECD). It provides the broad framework of corporate governance for countries to emulate taking into account their unique culture and regulatory and legislative systems. These principles are considered as a reference tool forcountries allover the world in developing their corporate governance codes.

OECD Principles of Corporate Governance(2004)

Ensuring the Basis for an Effective Corporate Governance Framework	The corporate governance 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.
The Rights of Shareholders and Key Ownership Functions	The corporate governance framework should protect and facilitate the exercise of shareholders' rights.
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.
The Role of Stakeholders in Corporate Governance	The corporate governance framework should recognize the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises
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.
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 its accountability to the company and the shareholders.

Developments of Corporate Governance Codes

Corporate governance reforms in capital markets and improvements in securities regulation have primarily been driven by corporate governance failure, scandals and systematic crises. Corporate governance over time has emerged from a set of self-imposed ethical restraints into a structured corporate code with statutory enforceability (Singh & Kumar, 2009).

Evolution of Corporate Governance Codes in the World

The collapse of some major corporations in the UK in 1990s was central to the concern of rise in interest of corporate governance there, and around the world.

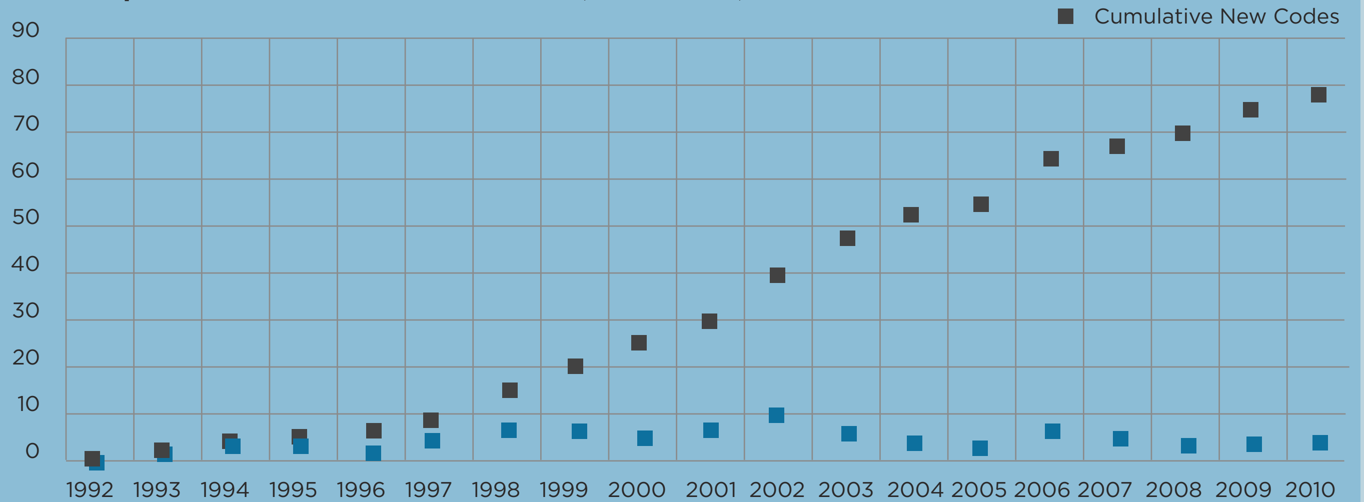
- The collapse of Bank of Credit and Commerce International (BCCI),, pension fraud in Maxwell Group, and scandal at Polly Peck implied serious weaknesses in the governance framework, particularly related to internal controls and financial reporting.
- The 1992 Cadbury Report of the UK, the first published report on corporate governance, significantly influenced the corporate governance debate and placed it on the top international agenda.
- The Report was followed by publication of a number of corporate codes in different industrialized countries. Some of those codes are the Bosch Report (1995) - Australia, the Cardon Report(1998) - Belgium, the Dey Report (1994) - Canada, the Vienot Report (1999) – France, the Peters Report (1997) - Netherlands, Swedish Academy Report (1994), King Report (1994) – South Africa etc.

Asian Financial Crisis - Exponential Rise of Corporate Governance Codes

The systematic failure of corporate governance in the Asian financial crisis highlighted the importance of the issue and placed the corporate governance reform agenda globally.

- The economic crisis of Southeast Asian countries (Malaysia, Thailand, Indonesia, Philippines) in 1997 and that of Russia and Brazil signified the importance of corporate governance in transitioning and emerging economies.
- The Asian crisis was mainly centered around fragile banks and over-leveraged companies coupled with weak transparency and disclosure norms.
- Linkage of good corporate governance with economic stability and socioeconomic development was evident after the crisis.
- Following the crisis, a number of proposals for reforming corporate governance were made both nationally and internationally. Both the Organization for Economic Co-operation and Development (OECD) and the Commonwealth Association of Corporate Governance (CACG) issued separate reports on the principles of effective corporate governance in 1999.
- There was an exponential rise in the new corporate governance codes issued by countries around the world.

New Corporate Governance Codes Issued (1992- 2010)



(Source: European Corporate Governance Institute – Index of all codes)

Early 21stCentury Crises - Consolidation of the Corporate Governance Codes

- The high profile corporate frauds of Enron, WorldCom, Adelphia, Tyco and Global Crossing in the US; Parmalat, Marconi, Royal Ahold and Vivendi Universal in Europe, and HIH and One-Tel in Australia in the early part of this century again brought into focus the issue of corporate mismanagement in the developed countries of the world.
- Stringent corporate governance reforms were undertaken in the US through legislation by enactment of the Sarbanes Oxley (SOX) Act in 2002. The OECD Principles of Corporate Governance were also revised in 2004.
- Corporate governance codes of most of the countries around the world also went underwent major revisions.

Global Financial Crises - New Directions to Corporate Governance

- The recent international financial crisis of 2008 was also a crisis of corporate governance and regulation. Poor corporate governance practices implicated through fragile and the inferior risk management system were cause of failure of many financial institutions.
- Poor practices related to the board of directors, faulty executive remuneration and incentive system, and inadequate transparency and disclosure norms.
- The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) was promulgated in the US, making significant changes in corporate governance regime. The UK Corporate Governance replaced erstwhile, the Combined Code in the UK.
- The OECD has recommended a number of best practices in the aftermath and also revised its corporate governance principles.
- In between the period of 2009-10, 23 countries that had atleast one corporate governance code issued 33 codes of good corporate governance.

Emerging Corporate Governance Best Practices

Following corporate governance practices have emerged sequel to global financial crisis recommended by the OECD (2010). Many of these are now part of several national corporate governance codes.

- Remuneration of executives should align with long-term interest of the company. Performance measures should be related to the strategic objectives of the company.
- Decision on remuneration should be made through an open and vigorous process. Disclosure on the same should be made to shareholders in the remuneration report.
- Remuneration Committee should be totally independent. They may take services of independent remuneration consultants for deciding remuneration terms and conditions.
- Remuneration policies and implementation measures are submitted to the AGM for allowing shareholders to express their opinion on it.
- The Board is responsible for instituting and overseeing the company's risk management system compatibility with the company's strategy and risk appetite. Disclosure of the process of the risk management and overall results of risk assessment.
- Separation of Chair of the Board and CEO of the company. In case of duality of the position, companies need to explainmeasures to avoid conflict of interest.
- Periodic, externally facilitated Board evaluations.The process and general results of evaluations should be disclosed to shareholders.
- “Fit and proper person test” may be applied in the Board members' selection criteria. The procedure and criteria for selection of the directors should be disclosed.
- The Board nomination committee should specify the skills and experience required by the Board and for identifying suitable candidates.
- Shareholders should be able to nominate their members on the board.
- The structure, compositions and working procedures of the Board should take into account and accommodate the complexity of the company.
- Disclosure of aggregate voting results at the annual general meeting of shareholders is disclosed by the company in a timely manner.

The Pathways: Rule based *versus* Principle based Approach

Corporate governance norms and codes in different countries have been instigated broadly either through principle based voluntary approach or rule based legislative approach. Pathways to corporate governance have been decided by the regulators based on the gravity of governance problem and evaluation of risk of failures. Due to the advent of higher cost of failures, voluntary norms become prescriptive and even attain legislative status.

Principle based Approach	Rule Based Approach
A "soft law" implementation of corporate governance, where companies are not necessarily bound to comply with norms. The UK Corporate Governance code is based on the "comply or explain" principle, where listed companies have to disclose that they have complied with the provisions of the code, and if they have taken a different stance, it need to be accompanied with reasons for non-compliance The approach allows companies flexibility in adopting their own corporate governance structure depending upon their size and requirements. It relies on effective market based mechanism for enforcement and compliance with the governance code. In the absence of any credible market forces, however, companies can easily get away with non-compliance. There is a possibility that companies may engage in following the routine "check-the-box" approach, and may use standard explanations for any deviations from the code.	Rule based legislative approach is prescriptive and a rigid way of implementing corporate governance norms on the companies. The US has adopted a rule based approach of implementing corporate governance through Sarbanes Oxely Act(2002)/ Dodd Frank Act (2010). The rule based aproach is based "one-size-fits-all" principle, with necessity for companies to comply with all the corporate governance provisions. It ensures higher compliance with corporate governance norms and practices. The compliance cost to companies is much higher as compared to the self-regulatory way, particularly for smaller companies.

Corporate Governance India

Ownership Structure and Corporate Governance Problem

Indian corporations reflect ownership concentration with the presence of a dominant majority shareholder, which has control over the policies and operations of an enterprise. This applies across the spectrum over Indian industries with dominant shareholders.

Domestic Companies	Companies owned and controlled by family owned and business group
Public Sector Enterprises	Companies with the government as the dominant shareholder
Multinational companies	Companies where the foriegn parent company is the dominant shareholder

In India, companies with dispersed shareholding exist only as an exception. India, therefore, reflects a family/state based model, where most of the companies are controlled either by family owned conglomerates or by the Government.

- Promoters are dominant shareholders in the Indian business context. Of the 1552 NSE listed firms, median stake of the promoters as in December, 2014 is 56.33 per cent.
- Due to little separation of ownership and control in Indian companies, agency conflict arises between majority and minority shareholders.
- Dominant shareholders can extract benefit from minority shareholders either through economic or social mechanisms.
- In the economic mechanism, as against disproportionate control rights, the dominant shareholder can expropriate wealth from minority in several ways, such as, through diverting company resources by selling assets, goods, or services through self-dealing transactions and through obtaining loans on preferential terms.
- Under the sociological aspect, promoters can easily instigate friends and allies in the top management and the Board, notwithstanding the minority shareholder rights. Board in that case is mostly driven under the influence of dominant controlling shareholders.

Corporate Governance Reforms in India

The concern for corporate governance in India started with a spate of scams and need for capital coupled with international developments (such as Cadbury Report). These reforms channeled through different agencies were aimed at improving corporate governance in India and certainly guided by Anglo-American corporate governance philosophy.

First Phase of Governance Reforms

- India's first corporate governance code was industry driven, known as the Confederation of Indian Industries (CII) Code that emanated in April, 1998. However, being voluntary in nature, it was not much effective.
- The Securities Exchange Board of India (SEBI) constituted the Kumar Mangalam Birla Committee on 7th April, 1999 to recommend on the introduction of a mandatory corporate governance code. A Clause 49 was inserted into the Listing Agreement as corporate governance code by the SEBI in 2000 for the listed companies to comply with it.
- Subsequent to the enactment of the SOX Act in the US, the Department of Company Affairs DCA Government of India, constituted Naresh Chandra Committee (2002) for strengthening the corporate governance provisions of the Companies Act, 1956.

- The SEBI established the Narayanamurthy Committee (2003) for suggesting measures for improvement in the prevailing corporate governance practices with a view to enhance the transparency and integrity of the Indian stock markets.
- The Clause 49 of Listing Agreement was revised in 2004. From 1st April 2006, compliance with the provisions of Clause 49 became mandatory for all listed companies.
- The Ministry of Corporate Affairs (MCA) constituted Irani Committee in December 2004 with the objective of revamping and reorganizing the Companies Act, 1956.
- The Companies Bill, 2008, presented in the parliament lapsed due to the dissolution of the 14th Lok Sabha, was reintroduced as the Companies Bill, 2009 on the August 5, 2009.

Corporate Governance in the aftermath of Satyam: Second Phase of Reforms

'Satyam', India's largest accounting fraud, highlighted corporate governance problems in Indian corporations. Revelations of corporate governance shortcomings acted as catalyst to carry a second phase of reforms in the country to address the lacunae. Both industry and regulators have initiated a number of measures to reform corporate governance in the country.

- The Confederation of Indian Industry (CII), soon after, constituted a task force under the Chairmanship of Shri Naresh Chandra (2009) that made recommendations for several reforms.
- The MCA on 24th December, 2009 provided Voluntary Guidelines on Corporate Governance that were recommendatory, based on the "comply or explain" approach. Many of the recommendations of the guidelines were included in the Companies Bill, 2011.
- The SEBI amended the Listing agreement on 5th April, 2010 for improving corporate transparency. These included the appointment of a Chief Financial Officer (CFO) by the audit committee (Clause 49), voluntary adoption of IFRS for consolidated financial reports, additional financial disclosure of half yearly balance sheet and insistence on peer review audit (Clause 41).
- On 13th August, 2012 the SEBI inserted a new Clause 55 in the Listing Agreement, making it mandatory for companies to publish Business Responsibility Report that was based on the MCA's "National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business" (2011). This is currently applicable to top 100 companies based on their market capitalization.
- In light of the huge number of amendments to the Companies Bill, 2009, the revised Bill was introduced in the Parliament on 14th December 2011, as the Companies Bill, 2011.
- The Companies Act, 2013 was enacted on 30th August, 2013 and provides for a major overhaul in the Corporate Governance norms for all companies. The Rules pertaining to Corporate Governance were notified on 27th March, 2014.
- The SEBI on 27th April, 2014 revised Clause 49 of the Listing Agreement to align it with the provisions of the Companies Act, 2013, adopt best practices and to make the corporate governance framework more effective. It was further revised on 15th September, 2014 to include some amendments.

An Insight into Indian Corporate Governance Code and Framework

Corporate governance in India reflects a rule based approach, where companies necessarily follow the provisions given in the Companies Act 2013 (and Clause 49 of the Listing Agreement, if applicable)

Applicability of Corporate Governance Norms

- *The SEBI's corporate governance code "Clause 49 of the Listing Agreement", applicable to all listed companies.*
- *Scope of corporate governance provisions of the "Companies Act, 2013" extends beyond listed companies to include the public companies, and even in some instances the private limited companies.*

Board of Directors

- The Board of directors under their responsibilities given in Section 166 of the Companies Act, 2013, "should act in good faith to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company, its employees, the shareholders, the community and for the protection of the environment."Board of directors are expected to identify legitimate interests and expectations of all stakeholders concerned, in achieving the company's objectives.
- An individual cannot hold the position of the Chairperson as well as the Managing Director/ Chief Executive Officer of the company – unless provided by the Articles of Association of such a company or if the company does not carry multiple businesses.
- The board of a listed and public company (paid up capital of Rs.100 crore or more/ turnover of Rs. 300 crore or more)) must have at least one woman director to ensure gender diversity.
- Formal annual evaluation by the Board of its own performance and that of its committees and individual directors.
- A public company must have a minimum of three directors and a maximum of fifteen directors. More directors may be appointed to the Board upon passing of a Special Resolution by the company.
- Board of directors' must have at least 4 meetings each year with not more than 120 days gap between two consecutive meetings.
- Board of directors of a listed company must have a code of conduct for the directors and senior management to comply with.
- Responsibility and liability for the directors are fixed and definitive. Directors are personally liable in their responsibility to maintain internal controls, fair financial statements, dealing with public money raised through a public offer or statements in a prospectus etc.

Independent directors

- Independent directors should not only have skill and expertise, but must also be persons of integrity and honesty, who may be trusted within the company by all stakeholders.
- Schedule IV of the Companies Act 2013 provides for the professional conduct, role and functions, duties, manner of appointment and removal and resignation of an Independent Director.

Companies Act, 2013 Clause 49 of the Listing Agreement: Public companies having paid up capital of Rs 10 crore or more/ turnover of Rs 10 crore or more/ outstanding loans, borrowing or debentures of more than Rs 50 crore must have at least two independent directors.Listed companies must have at least one-third of the total number of directors as independent directors.A person cannot become a director in more than 20 companies (including Pvt. Ltd. companies) and cannot accept directorship in more than 10 public companies.

Clause 49 of the Listing Agreement: Listed companies must have at least 50 per cent of non-executive directors. When the Chairman is promoter related non-executive director, the Board must have at least half of directors that are independent directors. A person cannot serve as an independent director in more than seven listed companies.

A whole time director of a listed company cannot be an independent director in more than three listed companies. Listed companies to provide suitable training to independent directors, details of which are to be disclosed on the Annual Report.

- Independent director (or a non-executive director) can be held liable, only in respect of such acts of omission or commission by a company which had occurred with his knowledge, attributable through Board processes, and with his consent or connivance or where he had not acted diligently.
- Independent directors are not entitled to any stock option and may receive remuneration by way of fee and profit related commission.
- An independent director may have two tenures of up to 5 years each. He cannot serve on the Boards of more than seven listed companies.
- Independent directors of a listed company are required to hold at least one meeting among themselves in a year, without the presence of non-independent directors.

Audit Committee

- Companies Act, 2013 Clause 49 of the Listing Agreement: Applicable to listed company and public company (paid up capital of Rs.10 Crore or more/turnover of Rs.10 Crore or more/outstanding loans or borrowing or debentures of more than Rs. 50 Crore). Minimum of three directors with independent directors forming a majority. The majority of the members, including its Chairperson, shall be persons with ability to read and understand the financial statement. Specific terms of reference as per duties with authority to to investigate into any matter in relation to discharge of its duties.
- Major responsibility towards approval of related party and overseeing the financial reporting process
- Responsible for the appointment, remuneration, removal and terms of appointment of external auditors. Review and monitoring of auditor independence and performance, effectiveness of the audit process.
- Other important responsibilities include: scrutiny of inter-corporate loans and investments; evaluation of internal financial controls and risk management systems, utilization of the proceeds of a public issue, functioning of the whistle-blower mechanism and valuation of assets

- Clause 49 of the Listing Agreement: Applicable to all listed companies Minimum of three directors with two-thirds of the members being dependent directors. The Chairman must be an independent director. All members of the audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise. Responsibilities in addition to that provided under the Companies Act, 2013:

Review of the quarterly financial statements

- Reviewing the adequacy of internal audit function and managing relationship and effectiveness of internal auditors
- Review of the reasons for substantial defaults in the payment to the depositors, debenture holders, shareholders and creditors
- Approval of appointment of CFO after assessing the qualifications, experience and background, etc. of the candidate

Nomination and Remuneration Committee

- Every listed company and other public company (paid up capital of Rs 10 Crore or more/ turnover of Rs 10 Crore or more/ outstanding loans or borrowing of more than Rs 50 Crore) should have a Nomination and Remuneration Committee with at least three non-executive directors, of which 50 per cent should be independent directors. Chairperson of the company cannot be the Chairperson of the Committee. In case of listed companies, Chairman of the committee must be an independent director (Clause 49 of the Listing Agreement).
- The Committee on part of nomination and appointment has the following responsibilities: identify persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, recommend to the Board their appointment and removal and carrying out evaluation of directors director's performance.
- The Committee has following responsibility in remuneration: formulate the criteria for determining qualifications, positive attributes and independence of a director and recommend to the Board on remuneration policy for directors and key managerial personnel (KMP).

Stakeholder Relationship Committee

- A company having more than 1000 shareholders, debenture-holders, deposit-holders and any other security holders at any time during a financial year has to constitute a Stakeholders Relationship Committee, with the Chairman being a non-executive director. It needs to consider and resolve grievances of security holders of the company.

Transparency in Dealings and Disclosure

- The director has direct responsibility (Section 166, Companies Act, 2013) in a situation, in which they may have a direct/ indirect interest which conflicts, or possibly may conflict, with the interest of the company. They should not achieve or intend to achieve any undue gain/advantage either to themselves or to their relatives, partners, or associates. Any director found guilty of taking undue gain is liable to pay an equal amount to the company

- Directors, promoters, shareholders and KMP may also have a direct conflict of interest due to a business transaction, referred to as related party transactions. To resolve an inherent conflict of interest in the related party transactions, the concerned related party is not eligible for voting on a resolution for passing the proposed transaction.

- Every related party transactions to be disclosed in the Board report to the shareholders along with the justification for entering into such contract or arrangement

- Vigil mechanism, where employee and directors can report their grievances and fraudulent activities, is to be established and disclosed.

Stringent Penalties as Deterrent Mechanism

- The company law in India, for the first time defines what is meant by "fraud" in relation to a company (Section 447, Companies Act, 2013).

- Acts of fraud under which a person can be held liable under Section 447, Companies Act, 2013 include: inducing persons to invest money (section 36), conducting business of the company with fraudulent or unlawful intent (section 206 (4) & 339 (3)); fraud, misfeasance or other misconduct or withholding of information (section 213); making false statements in the return/report/ certificate/ statement/any other document (section 448).

- Any person guilty of fraud under section 447 is punishable with imprisonment for a term extending from six months to ten years and fine no to be less than the amount involved in the fraud which may extend to three times the amount involved in the fraud. In case of fraud involving public interest, imprisonment term is not less than three years.

Independence and Accountability of the External Auditors

- Compulsory rotation of individual Auditors in every 5 years and of audit firm in every 10 years in listed companies and certain classes of unlisted public companies and private limited companies for ensuring independence of the auditors (section 139).

- Auditors cannot render specified non-audit services, directly or indirectly, to the Company, its Holding and Subsidiary Company to assure independence (section 144).

- Auditors of the company (also including, Cost Auditors/Secretarial Auditors) as gatekeepers are now responsible (under section 143) for reporting offenses of fraud to the Board immediately and to the Central Government after stipulated time period.

Shareholder Rights and Protection

- Shareholder of the company can participate in the AGM in person or through appointing a proxy. Shareholders of a listed company or public companies (having more than 1000 shareholders) have right to exercise their vote by the electronic means (section 108).

- Small shareholders (shareholders holding shares of nominal value of up to rupees twenty thousand) of a listed company may have one director on the Board (section 151).

- The company Law for the first time allows shareholders and depositors of the company to file class action suits (Section 245) against the company, its directors and auditors for any fraudulent, unlawful or wrongful act or omission or conduct. They are empowered to claim for the compensation or damages on account of fraud committed on them by the company, the directors and auditors of the company.

Enforcement by Regulators and Courts

- The Serious Fraud Investigation Office (SFIO) has been provided statutory status in the Companies Act (Section 211) for the purpose of investigating the affairs/fraud relating to a company. It is empowered as a sole authority to investigate such cases, papers, documents for such malafide practices that involve fraud.

- The SEBI, now in its legislative capacity can conduct investigations, substantially pass orders, seek information from any person or entity, and put strict sanctions for breaches of securities laws. It now has the powers to pass disgorgement orders for an amount equivalent to wrongful gains or to losses averted by contravention of regulations.
- For providing speedy trial of offenses, Special Courts may be established.

Corporate Social Responsibility (CSR)

- Every Company having net worth of rupees 500 crore or more, or turnover of rupees 1000 crore or more or a net profit of rupees 5 crore or more during any financial year, needs to have a CSR Committee with minimum three directors including at least one independent director (section 135) .
- Every company has to have its CSR policy approved by the Board and disclosed on the company's website and in the Annual report.
- The Board of every company shall ensure that the company spends, in every financial year, at least two per cent of its average net profits made during the three immediately preceding financial years, in pursuance of its CSR policy. Inc case of failure to do so, the company shall report the necessary reasons for not spending the same in their Board Report.

Environmental, Social and Governance (ESG): Business Responsibility Reports

- Under the Clause 55 of the Listing Agreement, listed companies are required to publish Business Responsibility (BR) Reportsdescribing the initiatives that have taken from an environmental, social and governance perspective.
- The business responsibility reporting is based on the nine principles given in the National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business'. The Guidelines prepared by the Indian Institute of Corporate Affairs (IICA) were released by the Ministry of Corporate Affairs, Government of India, in July 2011.
- The requirement of BR reporting applies to top 100 listed entities based on market capitalisation at BSE and NSE. For other the listed companies, it is voluntary to adopt and disclose it.

Nine Principles on Environmental, Social and Governance

Principle 1:

Businesses should conduct and govern themselves with Ethics, Transparency and Accountability

Principle 2:

Businesses should provide goods and services that are safe and contribute to sustainability throughout their life cycle

Principle 3:

Businesses should promote the wellbeing of all employees

Principle 4:

Businesses should respect the interests of, and be responsive towards all stakeholders, especially those who are disadvantaged, vulnerable and marginalized.

Principle 5:

Businesses should respect and promote human rights

Principle 6:

Business should respect, protect, and make efforts to restore the environment

Principle 7:

Businesses, when engaged in influencing public and regulatory policy, should do so in a responsible manner

Principle 8:

Businesses should support inclusive growth and equitable development

Principle 9:

Businesses should engage with and provide value to their customers and consumers in a responsible manner

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