Corporate Governance and Changing Regulations in India

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Abstract

By definition, the company is an association of persons coming together with pooling of resources for economic motives with pooling of resources. Its managers need to be ethical in dealing and managing other persons' resources. The accountability is there towards investors and other stake holders but still there have been many issues in governance of companies in India. The present paper is an attempt to take an over view of corporate governance practices in India. In the private sector, the Satyam case has resulted in eye opening shortcomings of in the corporate functioning. The greed and negligence of related parties, independent directors, auditors, bankers and others have led to this manipulation by the Managing Director Raju for many years. This has brought out many changes in the Indian Companies Act. The clause 49 has been improved, and the responsibilities of Key Managerial Personnel have been introduced in a serious manner. The fiduciary responsibilities of directors have become the focal point of all debates on the topic. The study seeks to sum up recent changes in Indian regulatory system governing the companies especially Indian Companies Act, 2013.

Keywords: *Corporate, Responsibility, Fiduciary, Governance and Environment.*

Introduction

The large professionally managed corporations are the distinctive economic entity of the twenty-first century. These multifunctional corporations are dominant players in mobilizing resources and information; adaptation of new technologies, products and services. They are voluntary associations of persons with diverse interests joining hands with the purpose of wealth creation. The accountability of managers and directors to owners has increased tremendously with the increasing awareness of empowered shareholders. But managers should not view the increased accountability as a threat rather it may become a vehicle for creating a common drive for business excellence. Good corporate governance is a powerful factor to build business effectiveness and growth. It enhances competence of the Board of

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Directors, co-operation and teamwork. A number of corporate failures occur due to subtle failures in the decision making process i.e. how Board of Directors and managers make decisions and monitor corporate performance.

As there is no charter for corporate governance, this is usually customized by the company in question according to the legal, economic and cultural environment in which the company has to function. Currently, there are sharply contrasting views and debatable issues about the goals and relevant processes of governance of corporations. These views include Entrepreneurial Theory derived from Economics, Shareholder Agency Theory from Finance and Managerial Theory covering both supportive and critical perspectives. A Stakeholder Theory concerning corporate governance is also currently evolving in Management literature. Each of these theories presents a different perception of the way the corporate governance should work. These theories suggest different understanding of objectives and the process of governance and managerial assessment.

While the structures or procedures of governance tend to vary from country to country due to diverse politico–legal, financial and cultural environments, there is an increasing awareness that in the era of globalization, companies should alter and redefine their governance standards. They are also required to re-deploy their resources to meet the expectations of their stakeholders, viz.; investors, vendors/ suppliers, creditors, customers, employees, and society at large. Moreover, there is a greater need for transparency and disclosure requirements. In a narrow sense, corporate governance involves a set of relationships amongst the company's management, its board of directors, shareholders, auditors and other stakeholders. These relationships involve various rules and incentives, provide the basis through which the objectives of the company are decided, and the means of achieving these objectives are determined. Thus, the key aspects of good corporate governance comprise of transparency of corporate structures and operations; the disclosure practices and accountability of managers and the board to the company; and corporate responsibility towards all the stakeholders.

According to a report of Organisation for Economic Cooperation and Development (OECD, April 1998), the global debate on governance revolves around mainly "to redefine the mission of the corporation in the modern economy, recognize the need to adapt corporate governance arrangements, to protect shareholders' rights and enable active investment and to align shareholders' interests with the other stakeholders while recognizing societal interests." Due to global deregulation and revolutionary changes in Information Technology, the corporate governance is of particular importance. As investment capital becomes more mobile, there is an increasing pressure and an increasing awareness for the fulfilment of social responsibilities, the capital providers now insist upon greater transparency, accountability and responsiveness to shareholders' interests.

Measures to be Adapted for Effective Governance

Corporate governance is aimed at creating a balance between both economic and social objectives as well as individual and collective goals. The concept of governance is based on the efficient use of resources and accountability for the custodian of these resources. According to the advisory Group (OECD, 1988), since the modern corporations need to improve its competitiveness, they need to develop agenda for corporate governance through both public and private sector initiatives in the following way :

- Setting mission with respect to increase in investors' long term value.
- Ensuring adaptability of corporate governance compatible with societal value system and aspirations.
- Protecting shareholder rights through fairness, transparency and accountability.
- shareholder rights of voting to strengthen the quality of corporate governance.
- Aligning the interests of shareholders and other stakeholders. Here, comes the important issue of appropriate remuneration schemes for managers. Performance linked compensation packages can be a useful tool here.

- Compatibility and recognition of societal objectives viz. equity, welfare and building healthy competitive private sector. measures to be undertaken by companies include complete and timely disclosure of relevant information, workplace equality not only in terms of stock participation but also actual participation in policy formulation, encouraging employee ownership at least up to ten percept.

Practices of Corporate Governance : A critical appraisal

In an article in Harvard Business Review, Mark Latham (1999) states that "the corporate governance system of all major countries is fundamentally flawed, because the connection between shareholders and the Board of Directors is non-existent. In theory, shareholders elect the Board to oversee the CEO on their behalf. But in practice, this 'election' is typically a rubber stamp approval of the unopposed chosen by the existing Board of Directors. Several mechanisms have been evolved in the United States, to compensate for this flaw including disclosure requirement, takeovers, minority shareholder protection and fiduciary duty laws, compensation linked to performance. But the fundamental shortcoming remains because each of these remedies solves only part of the problem, leaving a lot of scope for manipulation. The companies should take decisions as per the interests of the stakeholders.

Steps for better Corporate Governance :

Employees participation

Some researchers suggest workplace democracy through employee participation in management. Such companies make better use of employee capabilities and able to produce more wealth. In such companies, employees are given the financial and other relevant data needed to make a good decision as well as the training necessary to understand the financial impact of their work. Human involvement in all aspects of the work is a need of the hour for the enhancement of quality of work life and also for enhanced job satisfaction of the employee. Following are some suggestions to help improve corporate democracy, autonomy and transparency:

- The Board should encourage active participation of minority shareholders in day-to-day management and proportional representation of different categories should be permitted.

- The shareholders must exercise voting rights as a part of their fiduciary responsibilities.

- The company should appreciate institutional investors to meet the same fiduciary standards for selection of voting proxies in the interests of members at large.

- The Board should make it easier for shareholders to nominate board members in order to have more independent power.

- The company must allow shareholders to communicate with one another without undue interference.

Appointment of Independent Director:

Shareholders of the company should choose an independent agency for nominating directorial candidates. These intermediary firms can overlook the process of election of the Board. CEO's and their favourite directors may dissent with hiring, monitoring and intermediaries but they cannot stop it if a majority shareholders vote in favour. This would improve corporate governance in Asian countries. It would increase stock returns, reduce short-termism (which is a major problem in Indian Corporate world) and would create a system of democratic capitalism. The election of small shareholders' directors and representation of women on the Board is also a welcome change in norms. The role of independent directors needs to be enhanced and they should not only act as a mere stamping authority. They should take more active role in day-to-day decision making of the company for the larger interest of the company. They should keep their eyes open for any discrepancy or non-conformance of standard practices in fund transfers and management.

Evolving Corporate governance in India

The Confederation of Indian Industry (CII), was first to declare the voluntary code of corporate governance in 1998. Next initiative came from the Securities Exchange Board of India (SEBI) through introduction of Clause 49 as the li1sting agreement for the company. In 2002, the Naresh Chandra Committee submitted its report on corporate governance. Based on some of the recommendations of this committee, SEBI revised Clause 49 of the listing agreement which was implemented in 2006. The entire exercise was done to protect interests of the investor through better corporate governance and disclosure norms. In 2008, SEBI has again revised the Clause 49 in relation to appointment, powers and duties of independent directors and audit committees. Over and above , the Companies Act, 1956 has been amended several times, in areas such as postal ballots, listing of securities, dematerialisation of shares and setting up of internal audit committees. 'The Satyam Computers' case study has created new land marks in the history of corporate governance in terms of negligence on the part of auditors and independent directors. This case has become the foundation stone of the revised Indian Companies Act, 2013.

In order to survive the pressures of corporate responsibility, Indian companies need to understand the expectations of investors to provide timely and accurate information about financial performance and risk factors associated with projects. The Board of such companies need to solicitate the advantages of experienced investors along with knowledge of minority shareholders. If companies are actually going to highlight shareholder value, there is a greater need to facilitate independent monitoring of management and shared accountability. The role of independent directors should be enhanced in day-to-day management of the company and participation of employees in management should be encouraged to bring transparency. This creates more understanding with stakeholders of the company. The transparency in disclosure practices is significant in attaining effective good governance in fact, it is a pre-requisite.

Changes in Key Managerial Personnel (KMP) as per The India Company Act, 2013:

The Indian Companies Act, 2013 has incorporated many changes in roles and responsibilities of Directors. Women directors small shareholders directors and independent directors have been made mandatory for certain types of public companies. As per Act 2013, though formation of the committee under Board of Directors is mandatory, number cannot exceed four. Committees of the Board are Audit Committee, Nomination and Remuneration committee, Corporate Social Responsibility Committee and Stakeholders' Committee. The roles of these committees have been prescribed in order to ensure more transparency. The presence of independent and non-executive Directors in the Board ensure protection of investors' interest. The KMP remuneration has to be below 11 percent of net profits of the company. The maximum number of directorships is restricted to 15 in the Act. The introduction of clause 49 emphasizes on the appointment of Independent director as non-executive director. All these provisions are created to avert infamous cases like Satyam fraud which highlighted the need for greater restrictions on governance of the public limited companies in India.

There is an increased need for disclosure regarding related party transactions (that is all subsidies) in Indian corporate sector in order to win confidence of investors. With the implementation of International Accounting Standards, there will be more uniformity and compliance can be ensured in audit, etc. For a developing country like India, fraud cases like Satyam are the black spots in the way of foreign equity participation and flow of FDI in the corporate sector. The role of directors in the Satyam case is really disgraceful and out of place as they have failed to fulfil their fiduciary responsibilities towards investors. They were involved in insider trading and money transfers illegally to Maytas, another company.

Case Study 1: Satyam Computers Ltd.

This case is about a US$1.4 billion corporate governance fraud at India's fourth-largest information technology company: Satyam Computer Services. The company offered IT outsourcing services to around 690 clients, including 185 Fortune 500 companies such as GE, Nissan Motors and General Motors. By 2008, Satyam was a global company operating in 37 countries. The case traces the rise and fall of both Satyam and its founder, Raju, who was a celebrity in the corporate India.

In December 2008, Satyam announced acquisition of two companies - Maytas Properties and Maytas

Infrastructure, owned by the family members of Satyam's founder and Chairman Ramalinga Raju (Raju). Due to adverse reaction from institutional investors and the stock markets, the deal was withdrawn within 12 hours. Doubts were raised on the corporate governance practices of Satyam by investors questioning the company's Board on the ground for giving consent for the acquisition as it was a related party transaction.

After the deal was cancelled, four of the independent directors resigned from the Board of the company. In January 2009, chairman Raju declared that the profit figures of Satyam had been inflated for past several years. The statement further increased concerns about poor corporate governance practices at the company.

The Satyam scandal is a unique case of negligence of fiduciary duties, total collapse of ethical standards and a lack of corporate social responsibility. Many fake salary accounts were created and the assets and liabilities in the Balance Sheet were manipulated for several years. The Internal Auditor manipulated the expenditure and revenue by more than 50 percent. Raju created many fake bank accounts to show interest income. They completely window dressed the deals and showed inter-corporate loans. The SDRs borrowings never became part of the Balance Sheet. The liabilities were also manipulated and there was a lack of disclosure in related party transactions. This is a landmark corporate governance case in the history of corporate India which completely changed our perception about the way companies are managed in India. It became the foundation for amendments in disclosure practices and the role of directors in management of Indian companies in the revised Indian Companies Act, 2013.

On 7 January 2009, Saytam's Chairman, Ramalinga Raju, resigned after notifying board members and the Securities and Exchange Board of India (SEBI) that Satyam's accounts had been falsified. Raju confessed that Satyam's balance sheet of 2008, had the following irregularities: "He faked figures to the extent of Rs. 5040 crore of non-existent cash and bank balances as against Rs. 5361 crore in the books, accrued interest of Rs. 376 crore (non-existent), understated liability of Rs. 1230 crore on account of funds raised by Raju, and an overstated debtor's position of Rs. 490 crore. He accepted that Satyam had reported revenue of Rs. 2700 crore and an operating margin of Rs. 649 crore, while the actual revenue was Rs. 2112 crore and the margin was Rs. 61 crore".

Reasons for fraud

Many factors can be attributed to the Satyam fraud. The independent board members of Satyam, the institutional investor community, the SEBI, retail investors, and the external auditor—none of them, including professional investors, detected the malpractices. The following is a list of factors that contributed to the fraud: greed, ambitious corporate growth, deceptive reporting practices—lack of transparency, excessive interest in manipulating stock prices for speculation and insider trading, high executive incentives, nature of accounting rules, ESOPs issued to those who prepared fake bills, high risk deals that failed, audit failures (internal and external), aggressiveness of investment and negligence of commercial bank officials.

The role of the independent directors, auditors, internal and external both along with other directors is questionable in this case. Unethical practices, greed for money and manipulation marked the uprising of Satyam Computers and its mentor, Raju. This is a clear and shameful example of lack of control and governance in India's star company in the software sector. The culture at Satyam, especially dominated by the Board, characterized unethical practices. On one hand, Mr. Raju emerged as a corporate inspiration, while he was compromising with his own values for the good of the company. The Board was a party to his actions and stood as a blind spectator. But, in the end, truth prevails and those violating the legal, ethical, and social norms are booked for their fraud and lack of fiduciary duties.

Case Study 2: Reliance Industries Ltd.-example of Good Governance

The second case is about the Reliance Industries. The role of the Independent Directors, as per the Corporate Governance practices of Reliance, is to oversee the performance of the management, ensure accuracy of accounts, review the remuneration package for executive and non-executive directors, recommend the appointment of new members on the Board and on the company's senior positions, etc. Reliance also has the position of a Lead Independent Director who presides over all the meetings of Independent Directors. The article of association of company permits up to 14 directors. As on March 31, 2007, Reliance Board had 12 directors, of which seven are independent directors. If one looks at the composition of the Board one gets as picture as follows: A comparison of the Board composition at Reliance and ITC reveals that in both the companies, the percentage of executive directors to the total number is 33%. Other non-executive directors' percent of total number is about 58 percent. This exceeds the requirement of more than 50 as per clause 49.1 of Indian Companies Act.

Reliance also circulates among the Board members the disclosures/ declaration to be given by board members under sections 264, 297, 299, 305, 308 of the companies act 1956 as well as under section 13 (2) 10 (d), 10 (e) and 13 (4) regarding 'prohibition' of insider trading' and clause 49 of the listing agreement. This is a model example of implementation of clause 49 in the practical world.

Most companies are realizing the fact that good governance brings value to their performance and market standing. It rationalizes top management as it brings independent directors with fresh talent and ideas, experience limiting the responsibility of executive directors. It assures the integrity and authenticity of financial reporting and utilization of resources to the desirable purposes. Broadly, good governance results in over-all market confidence, better image, the efficiency of capital allocation and growth and development of the industrial base of the country. The image of the country from 'family owned business' culture is changed into 'professionally managed' businesses. The governance is a major issue among foreign institutional investors in India be it political or corporate governance. Various committees like Cadbury Committee, Ruthman committee, CII Report, and Narayan murthy report on corporate governance have also recommended a 'code of best practices' for the Board.

Conclusion

The present paper deals with the topic from a conceptual point of view. The topic has become quite relevant after changes in Indian Companies Act, 2013. The chapter focuses on the two case studies on Satyam Computers and Reliance Industries Ltd. which throw emphasis on fiduciary responsibilities of directors towards the company and shareholders. There is a greater need for transparency in related party transactions and disclosure practices in Indian companies.

The regulatory system should encourage flexibility, timely disclosure of adequate information, protection of shareholder rights and a greater transparency. Policy makers should frame unambiguous and consistent regulations for the capital market so as to protect the shareholders vis–a-vis fraud, dilution and insider-trading. The present scenario provides an opportunity to lay the foundation for a new system of improved corporate governance that brings in sizable outside shareholders and encourages transparency, strengthened minority shareholder rights, and sound capital markets.

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