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The Role of Regulatory Authorities in Maintaining Corporate Governance Standards in India

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Structured Abstract:

Purpose: This paper deals with some conceptual aspects of corporate governance in a descriptive manner. It also tries to study the role of regulatory authorities of corporate governance in maintaining the corporate governance standards in India.

Design / Methodology / Approach: This study is based on secondary sources of data, mainly collected from different books, journals, related websites and newspapers. In the first phrase, conceptual framework of corporate governance is highlighted and in the second, the provisions relating to corporate governance in the Companies Act 2013 and the guidelines of SEBI under the clause 35B and the revised clause 49 and its sub-clauses has been discussed and at the end this paper concludes the observations.

Findings: In India, the important regulatory authorities like Companies Act, SEBI, ICAI, and ICSI etc. are continuously framing various laws, rules, and regulations in order to have a good corporate governance system in corporate sector. The new provisions in the Companies Act 2013 and the guidelines of SEBI under the revised clause 49 and its sub-clauses will be more effective for good corporate governance practices in India.

Originality / Value: The role of regulatory authorities of corporate governance has been considered important to maintain the standards of corporate governance practices in India and this will acquainted all the stakeholders about the benefits of good corporate governance.

Keywords: Corporate Governance, Companies Act 2013, SEBI, Stakeholders.

Introduction

Any business entity i.e., firm is established by entrepreneurs or owners with the primary objectives of investing their funds to earn a good return. For this firms has operates some primary functions such as – organizing the required amount of funds, obtaining a good rate of return on investment, maximizing the growth value of the firm and finally maximizing shareholders value. However, the main aim of all the activities a firm undertakes is to maximize shareholders value because the shareholder's value can be used as performance indictor for effectiveness of management actions. The shareholders invest their hard earned money at the disposal of the managers or agents of the company. It is expected that the managers will utilize such monetary resources with the primary aim of maximizing the shareholder's wealth. This is however, does not happen many a times; since the shareholders are not in a position to monitor or exercise control over the managers decisions or performance, what exactly happens is that the managers utilize the money in a manner that serves sometimes their own interest. As a result, there is a gap of understanding in fulfilling interest between shareholders and the managers.

In a company, there are two groups of stakeholders–internal and external. The main external stakeholders groups are shareholders, debt holders, suppliers, customers, communities, clients, etc. whereas the internal stakeholders are the board of directors, executives, employees, officers, etc. Corporate governance provides a relationship between all the stakeholders. These relationships provide the framework through which the goals of the company are set and the methods of achieving these as well as performance monitoring are determined. In recent times, corporate governance has received increased attention because of occurrence of various scams or scandals involving abuse or misuse of corporate power or funds and in some cases the criminal activities by corporate officers. So it is the appropriate time to study about the corporate governance rules, regulations and laws for corporate sector in India.

This paper has been divided in to five sections. Section 1 introduces the background of the study. Section 2 explains the concept of corporate governance and its model. Section 3 discusses the needs and the principles of corporate governance Section 4 discuss the role of regulatory authorities in maintaining corporate governance standards in India and Section 5 concludes the paper.

Concept of Corporate Governance

Corporate governance is defined as the set of rules, processes or laws by which business corporations or companies are operated, regulated and controlled. It refers the relationship between all the stakeholders in a company. According to the Kumara Mangalam Birla Committee, instituted by the Securities and Exchange Board of India (SEBI) in 1999, corporate governance may be defined as the enhancement of long-term shareholders value, while at the same time, protecting the interests of other stakeholders. “Corporate Governance is the system by which companies are directed and controlled.” (The Cadbury Committee

U.K.) It includes company's accountability to shareholders and other stakeholders such as employees, suppliers, customers and local community.

In today's transforming business scenario, corporate governance is no longer a management Jargon, but a corporate necessary and the quality of corporate governance is one of the key drivers of value for shareholders. A well-established system of corporate governance includes the efficient use of available resources, value addition and wealth creation within the comprehensive framework of Corporate Philosophy. It aims to maintain a strong balance between economic and social goals as well as between individual and cooperative goals and fulfill the interests of individuals, corporations and society as far as possible. Corporate governance ensures transparency and accountability that lead to a strong and balanced economic growth and development. This also makes sure that the interest of all stakeholders is safeguarded and the companies fully recognized their rights. There are usually three key participants in corporate governance–the board of directors, management and the stakeholders of the firm. The complex interactions among these three participants can be graphically represented with the aid of corporate governance triangle.

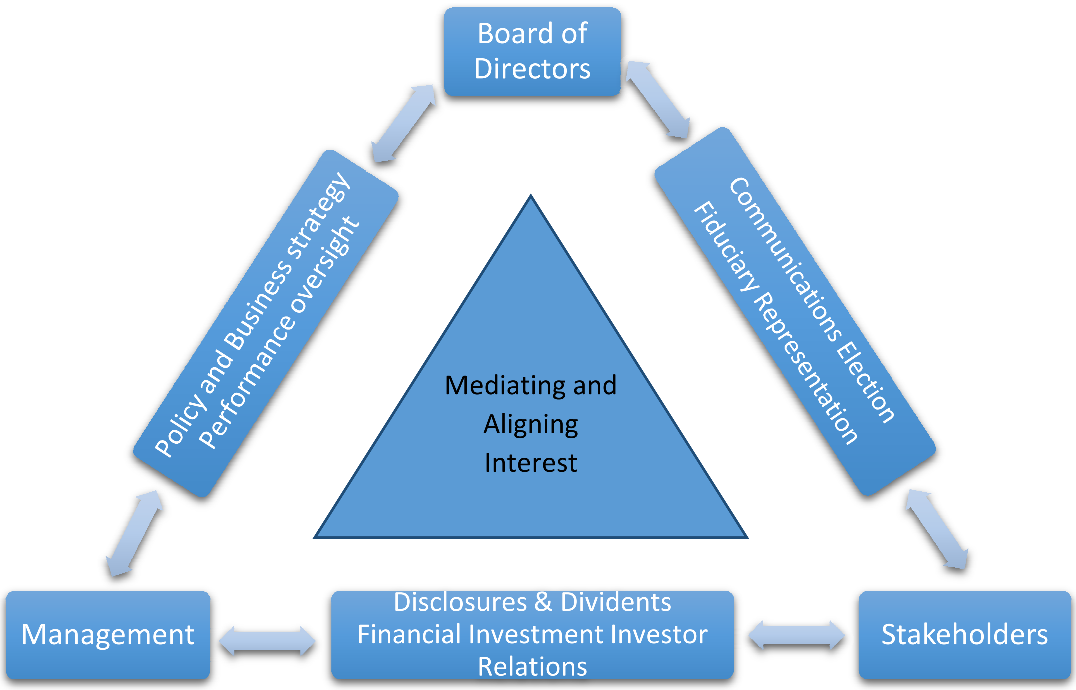

Fig. 1: Corporate Governance Model

The structure of the triangle represents the governance model where good corporate governance a balance equilibrium among the three participants. The board of directors is responsible for overseeing the represents performance of their management team, who are guarded through their performance. They also maintain a fiduciary relationship i.e., a relationship based on thrust with their stakeholders. The management policies and structure should be transparent enough to adequately disclose relevant information to their stakeholders and ensures timely payment of dividends for their investment in the business.

Good Corporate Governance relates to the adopted systems of disclosure and transparency which provide regulators, shareholders and the economy at large, with precise information regarding the financial, operational and other aspects of the organization. The bottom line for good Corporate Governance involves the dual aim of pursuing profits and doing so in a transparent and accountable manner. The most important aspect of corporate governance is therefore to encourage a trustworthy and an ethical environment by ensuring accurate and transparent disclosure of information at timely intervals.

Objectives of the Study

The following are the main objectives of the study:

- To understand the concept of corporate governance, its needs and the principles of good corporate governance.
- To examine the role of regulatory authorities in maintaining Corporate Governance Standards in India.

Methodology of the Study

The study is based on secondary sources of data mainly from different books, journals and newspapers. In order to enrich the study, the related websites have been searched as and when required. Editing and classification of the above mentioned sources of data have been done as per requirement of the study.

Need for Corporate Governance

Following are the needs for which it is necessary to study about corporate governance:

Conflict of interest between owners and management: In a typical business, model, the shareholders invest their hard earned money at the disposal of the manager of the company. It is expected that the managers will utilize such monetary resources with the primary aim of maximizing the shareholders' value. This however, does not happen many a times. Since the shareholders are not in a position to monitor or exercise control over the manager's decision or performance, what exactly happens is that the managers utilize the money in a manner that serves their own interest. This is known as agency issue. Shareholders with a view to protecting their own interest, take various steps to monitor the actions and decisions of managers. These involve costs commonly referred to as agency costs. So in order to minimize agency costs, a good corporate governance model need to be put in place.

Unethical business transactions: In the past many years, there have been an increasing number of scams, frauds and misdeeds by the companies. The public money has been misused and inappropriately handled in various companies, banks, financial institutions etc. The typical examples of such firms are Enron, Satyam, Cadbury, Wal-Mart. In order to prevent such occurrences involving the public money, there is a strong requirement of good corporate governance structure.

Change in ownership structure: In recent years, there has occurred a change in the ownership structure of companies. Previously, large Indian companies were primarily owned by the Indian promoters and the business used to run in families. However, a recent shift take place, wherein foreign institutional investors are consolidating their holdings is quite evident. There is now an increase in institutional ownership of the companies i.e., the mutual funds, banks, financial institutions, insurance companies, foreign institutional investors etc. are the largest shareholders in most of the large companies. These institutions compel the management to work efficiently, profitably and transparently. Hence the changing ownership structure requires the need for good corporate governance.

Globalization: In recent years, companies are doing business and selling their products globally. In order to attract business from foreign customers, investors and companies, the foreign regulations are to be complied with the expectation are to be met. In order to succeed in an over challenging foreign environment, a good corporate governance practices has to be followed by the companies. We can produce an example form one of the biggest corporate scam in India - Satyam Computer Services Ltd. scam. On 7th January 2009, Mr. B. Ramalinga Raju, Chairman of Satyam Computer Services Ltd., claimed in a letter to the board of directors that he had been manipulating the Company's accounting for a number of years since 2001 to inflate Profits and Cash flows. A glance of the reported and actual figures of financial Statement for the 2nd quarter ending 30.9.2008 will provided the nature of the fraud (Table 1).

The Balance Sheet of Satyam Contained certain irregularities – First of all, there is non-existence of cash and bank balance of Rs. 5040 Core, non-existent of accrued interest of Rs. 376 Core, overstated debtors by Rs. 490 Core and understated liability of Rs1230 core. It is also stated that the reported revenue of Rs. 2700 and an operating margin of Rs. 649 core whereas the actual figure was Rs. 2112 core and Rs. 61 core respectively. So there exists an over stated revenue and operating Profit as per income statement of Satyam. Actually the case study of Satyam Computer Services Ltd. is an instance of Poor Corporate governance in India. There may be several reasons behind the fraud but the fact is that it has failed on every issues of corporate governance and neglects every government regulators like SEBI, ROC and MCA.

Principles of Good Corporate Governance

Following are the principles for which it is necessary to study about corporate governance:

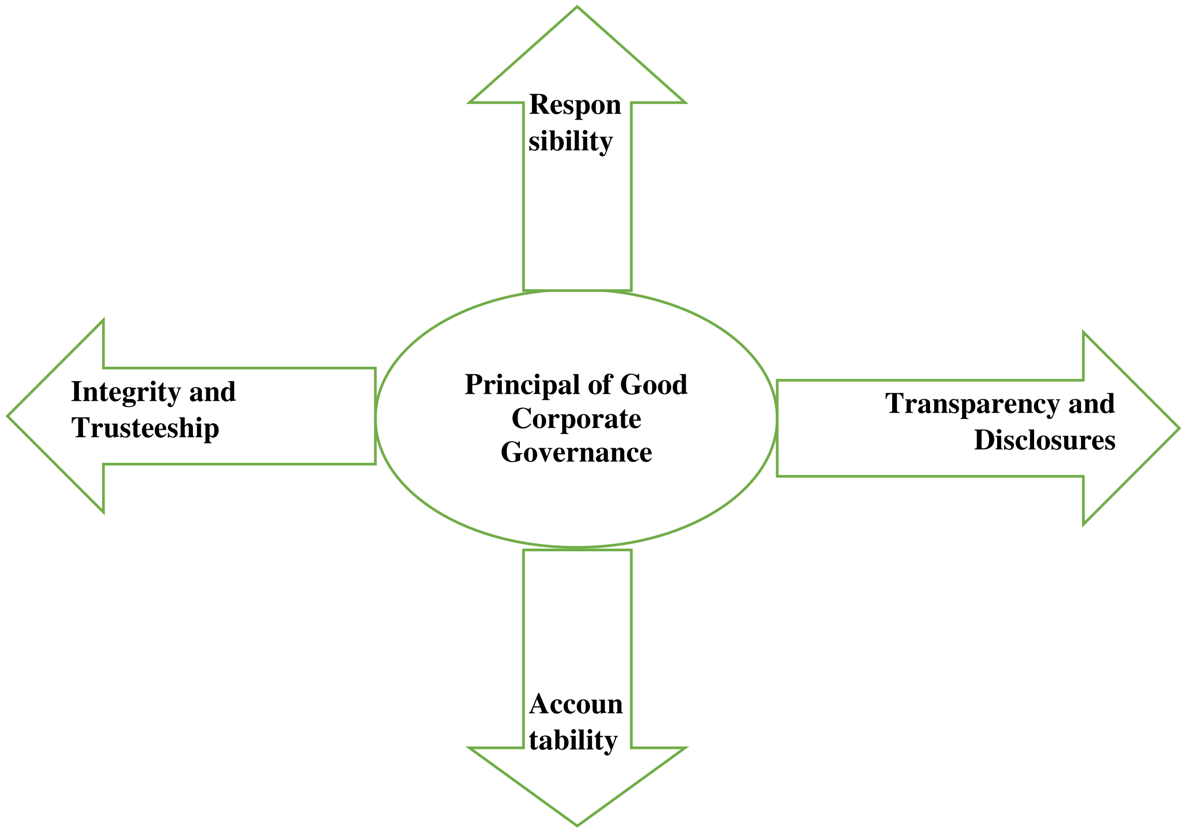

Fig. 2: Principal of Good Corporate Governance

Effective corporate governance revolves around the following interconnected components:

Transparency and Disclosures: Transparency refers to the ease with which a person or a group outside the company is able to analyse and make a meaningful deduction of the company's financial as well as non-financial fundamentals. The company should make timely and accurately disclosure of factual and clear information such as financial status, ownership, performance, etc. In short, outsiders should be able to comprehend and construct an accurate picture of what actually happening within the company.

Integrity and Trusteeship: It is the responsibility of the board of directors to inculcate the sense of integrity and trusteeship among the management personnel. The board of directors and top management of the firm must practice these values themselves and create an environment where honesty, fair play and integrity of high order are clearly displayed. Trusteeship involves performing management functions with a sense of trust.

Responsibility: Top management must be made responsible to the board of directors who in turn are accountable to shareholders and other stakeholders. In good corporate governance, the firm must own and take responsibility to maintain a high level of ethical standards.

Accountability: The managers in a company who are involved in decision making and taking actions on important issues should be held accountable for their decisions and actions. There must be systems and procedures in place within the company that compel the managers to be accountable for their actions.

Regulatory Authorities of Corporate Governance in India

The Indian statutory framework of corporate governance has been in consonance with the international best practices of corporate governance. In India following are the regulatory authorities which are providing guidelines and framework on corporate governance (Table 2).

Companies Act 1956 and 2013: Companies Act 1956 provides the basic outline for administering the companies. Ministry of corporate affairs made several revisions and amendments on corporate governance practices of the concern. The companies Act 2013 inter-alia contains provisions relating to board constitution, board meeting, independent directors, audit committee, corporate social responsibility, internal auditor, related party transactions etc.

Securities and Exchange Board of India (SEBI): SEBI is the regulatory of the securities market and corporate governance standards which provides rules, regulations, guidelines to ensure protection of investors. For companies whose shares are listed on the Stock Exchanges, by listing agreement, it ensures that companies are following good corporate governance.

The Institute of Chartered Accountants of India (ICAI): ICAI is an autonomous body which issues accounting standards to ensure the better corporate governance. ICAI give lot of importance as it leads to effective disclosure of accounting standards and reduces the gap between Indian and International accounting standards.

The Institute of Company Secretaries of India (ICSI): ICSI is an autonomous body which issues secretarial standards in terms of provisions of the new companies Act to maintain the good corporate governance in corporate sector.

The benchmark of corporate governance in India was the development of various financial institutions and the Companies Development and Regulation Act 1956. The financial institution such as IDBI, IFCI, ICICI, etc. acted as intermediaries of financial markets. Their role is therefore to transfer funds from investors to companies. In this way, the funds were made available for the overall industrial development in the country. However with the passage of time, there occurred various scandals in corporate sector and stock markets which included Harshad Mehta Securities Scam, allotment to company shares to promoters at highly discounted prices etc. These serious scandals as well as the opening up the corporate markets to competitive global players led to the setting up of various committees with the aim of investigating various scandals. The committees provide various recommendations for transparent and efficient corporate governance. Some of the Key Committees recommendations are highlighted as follows:

Companies Act 2013 in Corporate Governance Standards: Companies Act 2013 has incorporated a number of Provisions with a view to implement and improves the corporate governance framework in Indian Corporate sector. The important provisions of this Act are:

1. Directors Responsibilities Statement [Sec. 134 (5)]
2. Corporate Social Responsibility [Sec. 135]
3. Board Composition [Sec. 149]
4. Manner of Selection Independent Directors [Sec. 150]
5. No of Directorships [Sec. 165]
6. No Duties of Directors [Sec. 160]
7. Audit Committee [Sec. 177]
8. Nomination and Remuneration Committee [Sec. 178]
9. Discloser of Interest by Directors [Sec. 184]
10. Related party transactions [Sec. 188]
11. Provisions of Insider Training of Securities [Sec. 195]
12. Provision forward Dealings in Securities [Sec. 194]

Here we have mentioned some important provisions of this Act relating to corporate governance standards: Sec. 149 states that it is the first time in the Companies Act to introduce independent directors and women director in the composition of board of directors in the listed company. All listed companies should have at least one–third of the board members as independent director. A company whether private or public company will be mandatorily appoint at least one women director in cases-it is a listed company and the paid up capital Rs. 100 crores or more and a turnover of Rs. 300 crores or more. Sec 166 prescribed the duties of a director. This helps directors to have more clarity on their duties and responsibilities .Sec 138 mandates appointment of internal auditor by prescribed class of companies. It is an important aspect in the overall monitoring of the functions of a company. Sec. 135 deals with corporate social responsibility (CSR) which is mandatory for all profit making companies to spend a fixed percentage (2%) of the average net profit towards social development activities. A company has to constitute a board level committee to monitor such activities.

The Role of SEBI in Corporate Governance

To make corporate governance more effective, the SEBI since its set up in 1992 has taken up number of initiatives appointed various Committees and has brought amendments to the clause 35B and the clause 49 of listing agreement. Here the SEBI `s role in corporate governance is illustrated through norms and provisions as stated these two clauses.

Clause 35B: Under the revised clause, the company has to provide e- voting facility in respect of all shareholders resolutions to be passed at general meeting or postal ballot facility to shareholders. The Company has to sent notices of meeting to all members, auditors and directors by post or registered e-mail or courier and the same be placed in the official website of the company. The notice of meeting should also mention that the company is providing facility for voting by electronic means and postal ballot facilities to members. Through this provision, large number of shareholders can participate in selection of board members.

Revised Clause 49, its sub-clauses: The SEBI has replaced the existing clause 49 of the listing agreement with a revised clause 49 (New clause). The new clause which was effective from October 1, 2014, is in alignment with the corporate governance norms as required under the new companies Act 2013. This clause will also provide the details about the compliance of norms by the listed companies but as per SEBI clarification, in future this clause will be applicable to non-listing companies also. The amended clause 49 has 11 sub-clauses containing the provisions of compliances under corporate governance norms. These are –

Clause 49 (i) – Corporate Governance Principles – Under this clause SEBI specify and explain the rights of shareholders and other stakeholders, the responsibility of corporate to protect stakeholder interest, duties and responsibility of the board. This clause also highlight that the disclosure of accounting and non-accounting information's must be made regarding proper compliance of prescribed accounting standards.

Clause 49 (ii) Board of Directors – This sub-clause specifies the composition of board, inclusion of restrictions on independent directors, the tenure, corporate code of conduct and whistle blowing policy.

Board Composition – This sub-clause specifies optimum composition of board of directors where at least 50% of the board members should be non-executive directors and there must be one women director in the board, if chairman is an executive director, half of the board must comprise of independent directors. However, if the chairman is a non-executive director, then 1/3rd board members are independent directors.

Restrictions in Independent Directorship – Under the revised clause, no person can be an independent director of more than seven listed companies. If there is a whole time director in any listed company, then he / she shall not be the independent director of more than three listed companies. The tenure of independent director will be five years which is in accordance with the provision of new companies Act 2013.

Code of Conduct – All board members and senior management personnel shall affirm compliance with the code on an annual basis. The annual report of the company shall content a declaration to this effect signed by the CEO. The board of directors is responsible to lay down a code of conduct for all board members and senior management of the company and the same should be displayed in the official website of the company.

Whistle Blowing – Whistle blowing policy will become mandatory under the revised clause 49 of listing agreement and will be a radical step in maintaining the standards of corporate governance. This gives protections to all stakeholders on all fraudulent activities in the company.

Clause 49 (iii) Audit Committee – As per the clause, the audit committee should have 3 members out of which $2/3^{rd}$ members be independent directors. All the members must be financially literate and one must be an expert in accounting or related financial management. The committee has to conduct meeting at least 4 times in a year with a gap of not more than 4 months in between two meetings.

Clause (iv) Nomination and Remuneration Committee – There should be three members in the nomination and remuneration committee and all members are non-executive directors and half of them are independent directors. The role of the committee includes formulation of criteria for determine qualifications, positive attributes and independence of a director and recommendation to the board policies relating to remuneration of directors and employees, key managerial personnel.

Clause 49 (V) Requirements for Subsidiary Companies – This sub clause specifies the responsibilities of listed and unlisted subsidiaries of listed holding companies. a) at least one independent director of the holding Company should be director of the board of directors of materially unlisted Indian Subsidiary Company. b) the audit committee of the listed holding has to review the financial statements in particular the investment made by the unlisted Subsidiary Company.

Clause (vi) Risk Management – The company through its board of directors shall constitute a Risk Management Committee. The board shall defined the role and responsibilities of risk management committee and may delegate monitoring and reviewing of the risk management plan to the committee and such other functions as may deem fit.

Clause (vii) – Related Party Transactions – A related party transaction is a transfer of resources, services or obligations between a company and a related party, regardless of whether a price is changed. A related party is a person or entity that is related to the company. Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party directly or indirectly in making financial and or operating decisions. In this clause, related party transactions information should be disclosed periodically in the form of summary before the audit committee in the ordinary course of business. Related party transactions now require shareholders' approval instead of board's approval as previously.

Clause 49 (viii) Disclosure Norms – This clause states the details of quarterly report should be disclosed on all material facts, related party transactions along with compliance report on corporate governance. It must be disclosed on companies website and a web link stated in its annual report.

Clause 49 (ix) – CEO / CFO Certificate – This sub-clause, states that Board of Directors, Chief Executive Officer (ECO) and Chief Financial Officer (CFO) has been made more responsible and answerable. They must certify that they have reviewed the financial statements and cash flow statements to the best of their knowledge.

Clause (x) and (xi) Compliance Certificate on Corporate Governance – Under this clause, SEBI requires corporate to obtain the certificate of compliance on corporate governance from the auditor of the company or from a practicing company secretary. Such certificate should be attached separately in the annual report and the same to the Stock Exchange along with the annual report.

Conclusion

Corporate governance deals with laws, procedures and practices by which companies (firms) are regulated, operated and controlled. It is actually the relationships between all the stakeholders in a particular company, corporate governance has come in to focus due to occurrence of various scams and scandals involving misuse of corporate funds. The corporate governance failures across the world led to the development of corporate governance codes. High Profile Scams like Enron and WorldCom in abroad and Satyam in India have shaken the Corporate World and implicated the need of strong corporate governance mechanism. The main principles of good corporate governance are transparency, disclosures, trusteeship and accountability. A sound corporate governance system will increase the confidence of investors, attract foreign investment and maximize shareholders value.

In India, the important regulatory authorities like, SEBI, companies Act, ICAI and ICSI, etc. are continuously framing various laws, rules and regulations in order to have a good corporate governance system in corporate sector. The new provisions in the companies Act 2013 and the guidelines of SEBI under the new clause 35B and the revised clause 49 and its sub-clauses will be more effective for good corporate governance practices in India. No doubt the Companies Act and SEBI have plays an important role in framing guidelines and power to make companies to follow the corporate governance standards. But the can not only enforce and monitor the compliance of corporate governance standards. Corporate governance is a long-term process and requires collective efforts by all market players including regulators, institutional investors, creditors, directors, shareholders and so on. Ethical value based corporate cultures are to be created within an organization.

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APPENDIX

Table 1: Some Actual and Reported Financial Figures of Satyam for the 2nd Quarter Ending on 30/09/2008 (Rs. In Core)

Items (Rs. In Core)	Actual	Reported	Fictitious Amount
Cash and Bank balances	321	5361	5040
Accrued Interest on bank Fixed Deposit	NIL	376.5	376.5
Understated Liability	1230	NONE	1230
Overstated Debtors	2161	2651	490
Total			7136
Revenues (Q2 FY 2009)	2112	2700	588
Operating Profits	61	649	588

Source: The Business Today, February 8, 2009.

Table 2: The Chronology of Corporate Governance Regulations in India

Year	Authority	Outcome
1998	CII	Voluntary code of Corporate Governance.
1999	SEBI	Kumar Mangalam Birla Committee- Corporate Governance from investors and shareholders perspective and to come up with a code that best suited in Indian environment.
2000	SEBI	Clause 49 of Listing Agreement.
2002	Department of Company Affairs (DCA)	Naresh Chandra Committee Report – Recommendations about audit committee, functions and responsibilities of auditors.
2002	SEBI	Narayan Murti Committee – To review clause 49 and also to suggest measures to improve corporate governance standards.
2004	Ministry of Corporate Affairs (MCA)	J. J. Irani Committee – New Company Bill Draft.
2011	SEBI	Revised – Substantial acquisitions of shares and takeovers.
2013	MCA	Companies Act, 2013.
2014	SEBI	Revised Clause 49 conforming the New Companies Act 2013.

Source: Compiled by the Author.