REGULATORY STRUCTURE, MECHANISM AND PRINCIPLES OF CORPORATE GOVERNANCE IN INDIA

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INTRODUCTION

In India, the question of corporate Governance has come up mainly in the wake of economic liberalization and de-regularization of industry and business. Various committees set up by the industry, reports and recommendations made by the Securities and Exchange Board of India and the Ministry of Corporate Affairs covered every subject of importance to corporate governance. In India, the development of corporate laws has been marked by interesting contrasts. In terms of corporate laws and financial system, India emerged far better endowed than most other colonies. The years since liberalization, have witnessed wide-ranging changes in both laws and regulations driving corporate governance as well as general consciousness about it. It is evident from the various legal and regulatory frameworks and Committees set up for the corporate functioning. Such laws, regulatory framework and recommendations of the committees are as follows:

LIST OF REGULATORS

I. The Ministry of Corporate Affairs (MCA), Government of India (MCA) regulates corporate affairs in India through the Companies Act, 1956, 2013 and other allied acts, bills and rules. It also protects investors and offers many important services to stakeholders. It also prevents adverse competition through Competition Act, 2002 and also promotes and sustains competition.

II. The Serious Fraud Investigation Office – It is multi-disciplinary organization to investigate serious financial frauds. It normally takes up investigations which are multi-disciplinary in nature and involve substantial public interest and many other factors.

III. The Company Law Board – It is a quasi-judicial body established under the Companies Act of 1956. It has power to regulate its own procedure.

IV. The Registrar of Companies – It is formed under the companies Act 1956. It is vested with the primary duty of registering companies and ensuring that such companies comply with the statutory requirements under the act.

V. Securities Contract Regulation Act, 1956: It covers all types of tradable government paper, shares, stocks, bonds, debentures, and other forms of marketable securities issued by companies. The SCRA defines the parameters of conduct of stock exchanges as well as its powers.

VI. Securities and Exchange Board of India – Its basic function is to protect the interest of investors in securities. It promotes the development of securities market. It also regulates the securities market and matters connected with it. It also prohibit fraudulent and unfair trade practices relating to securities market, promoting investor education and training of intermediaries of securities market, regulating substantial acquisition of shares and takeovers of companies and also promotes and regulates self-regulatory organizations.

VII. Enforcement Directorate – It is a specialised investigating agency under the Ministry of Finance which enforces Foreign Exchange and Management Act (FEMA) and Prevention of Money Laundering Act (PMLA). Foreign Exchange and Management Act is a civil law having quasi-judicial powers for investigating suspected contraventions of exchange control laws and regulations with the powers to impose penalty. Prevention of Money Laundering Act is a criminal law, whereby the officers are empowered to conduct enquiries to locate, provisionally attach/ confiscate assets.

PRINCIPLE LAWS AND REGULATIONS

I. The Indian Companies Act, 1956

II. The Depositories Act, 1996: This established share and securities depositories, and created the legal framework for dematerialization of securities.

III. Securities and Exchange Board of India Act, 1992 - This established the independent capital market regulatory authority, SEBI, with the objective to protect the interests of investors in securities, and promote and regulate the securities market.

IV. Arbitration and Conciliation Act, 1996;

V. SEBI Code on Corporate Governance,1998

VI. Clause 49: Clause 49 of the Equity Listing Agreement consists of mandatory as well as non-mandatory provisions. Those which are absolutely essential for corporate governance can be defined with precision and which can be enforced without any legislative amendments are classified as mandatory. Others, which are either desirable or which may require change of laws are classified as non-mandatory. The non-mandatory requirements may be implemented at the discretion of the company. However, the disclosures of the compliance with mandatory requirements and adoption (and compliance) / non-adoption of the non-mandatory requirements shall be made in the section on corporate governance of the Annual Report;

VII. Foreign Exchange Management Act, 2000;

VIII. The Competition Act, 2002.

Before discussing the state of the corporate governance in India and its economy, it is important to provide some basic details. India is a large country with considerable heterogeneity in its population and economic base. India has more than 20 official languages spoken by ova (Yasheng Huang & Tam Khanna,) 1 Billion spired spread throughout roughly 29 states with significant rural and urban populations. As the geographic and climatic conditions are varying greatly throughout India, there exists wide range of goods and services in the global market milieu.

The theme of corporate governance is to make sure the accountability of certain individuals in an organization through mechanisms that try to reduce or eliminate the principal-agent problem. The corporate governance is a multi-faceted subject. A related but separate thread of discussions focuses on the impact of a corporate governance system in economic efficiency, with a strong emphasis on shareholders' welfare. There are yet other aspects to the corporate

governance subject, such as the stakeholder view and the corporate governance models around the world. In India, the question of corporate governance has come up mainly in the wake of economic liberalization, deregulation of industry and business, the demand for a new corporate ethos and stricter compliance with the law of the land. In the context of the unique situation in India where the financial institutions hold substantial stakes in companies, the accountability of the directors, including nonexecutive directors and nominees, has come into sharp focus. (Paradigm charted secretary 1997).[1]

In India, a strident demand for evolving a code of good practices by the corporates themselves is emerging. In the global perspective, it may constitute a necessity to cut through the maze of prevalent questionable practices, indefensible management attitudes to stakeholders and penetrable non-disclosures. The initiatives taken by the Government in 1991, aimed at economic liberalization and globalization of the domestic economy, led India to initiate reform process in order to suitably respond to the developments taking place the world over. On account of the interest generated by Cadbury Committee Report[2], the Confederation of Indian Industry (CII), the Associated Chambers of Commerce and Industry (ASSOCHAM) and, the Securities and Exchange Board of India (SEBI) constituted Committees to recommend framework for good corporate Governance. (National Corporate Governance Policy, 2012). An examination of practices of accounting standards, and their issues in Indian industry may help to understand the existing practices of accounting standards, which in turn help in designing the effective standard practices so as to ensure good Corporate Governance. In this context, an attempt is made here to examine the accounting standards and their practices in India, with a view to strengthen the accounting standards and improve their practices for good Corporate Governance. (K.Shankaraiah. D.N. Rao)[3]

There have been several major corporate governance initiatives launched in India since the mid-1990s. The first was by the Confederation of Indian Industry (CII), India's largest industry and business association, which came up with the first voluntary code of corporate governance in 1998. The second was by the SEBI, now enshrined as Clause 49 of the listing agreement. The third was the Naresh Chandra Committee, which submitted its report in 2002. The fourth

[1] A.K. Vashisht B.B. Tandon P.P. Arya, - 2006 -A. K. Vashisht Corporate governance 'Corporate Governance: 'The New Paradigm', Chartered Secretary, October 1997. 'Corporate Governance: In India and Abroad
[2] https://www.governance.co.uk/resources/item/255-the-cadbury-report
[3]http://foreignpolicy.com/2003/07/01/can-india-overtake-china/

was again by SEBI the Narayana Murthy Committee, which also submitted its report in 2002. Based on some of the recommendations of this committee, SEBI revised Clause 49 of the listing agreement in August 2003. Subsequently, SEBI withdrew the revised Clause 49 in December 2003[4], and currently, the original Clause 49 is in force. But the corporate governance reforms in India are at a crossroads now; while corporate governance codes have been drafted with a deep understanding of the governance standards around the world, there is still a need to 'focus on developing more appropriate solutions that would evolve from within and, therefore, address the India-specific challenges more efficiently. (Santosh Pande Kshama V Kaushik)

CORPORATE GOVERNANCE FRAMEWORK IN INDIA

Ever since India's biggest-ever corporate fraud and governance failure unearthed at Satyam Computer Services Limited, the concerns about good Corporate Governance have increased phenomenally.

Internationally, there has been a great deal of debate going on for quite some time. The famous Cadbury Committee defined "Corporate Governance" in its Report (Financial Aspects of Corporate Governance, published in 1992)[5] as "the system by which companies are directed and controlled".

The Organisation for Economic Cooperation and Development (OECD), which, in 1999, published its Principles of Corporate Governance gives a very comprehensive definition of corporate governance, as under:

"A set of relationships 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 performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and shareholders, and

[4] Available at http://www.sebi.gov.in/sebi_data/attachdocs/1293168356651.pdf
[5] Corporate Governance and Disclosure Quality Accounting and Business Research Volume 22, 1992 - Issue 86

should facilitate effective monitoring; thereby encouraging firms to use recourses more efficiently."[6]

REGULATORY FRAMEWORK

The Indian statutory framework has, by and large, been in consonance with the international best practices of corporate governance. Broadly speaking, the corporate governance mechanism for companies in India is enumerated in the following enactments/ regulations/ guidelines/ listing agreement:

1. *The Companies Act, 2013*: Inter alia contains provisions relating to board constitution, board meetings, board processes, independent directors, general meetings, audit committees, related party transactions, disclosure requirements in financial statements, etc.
2. *Securities and Exchange Board of India (SEBI) Guidelines:* SEBI is a regulatory authority having jurisdiction over listed companies and which issues regulations, rules and guidelines to companies to ensure protection of investors.[7]
3. *SEBI Act 1996*: The SEBI Act 1996 was introduced to protect investors in securities, promote development and regulate securities market in India. It provides the duties of the Securities and Exchange Board of India (Sebi), which include regulating intermediaries, takeovers, issue of capital and stock-exchanges as well as preventing insider trading, unfair trade practice and market manipulation.[8]
4. *Standard Listing Agreement of Stock Exchanges*: For companies whose shares are listed on the stock exchanges.
5. *Accounting Standards issued by the Institute of Chartered Accountants of India (ICAI):* ICAI is an autonomous body, which issues accounting standards providing guidelines for disclosures of financial information. Section 129 of the New Companies Act inter alia provides that the financial statements shall give a true and fair view of the state of affairs of the company or companies, comply with the accounting standards notified

[6] Available at https://www.oecd.org/corporate/ca/corporategovernanceprinciples/31557724.pdf
[7] Available at http://www.sebi.gov.in/Last visited on 09-02-2018
[8] Available at http://www.sebi.gov.in/web/home/list/1/1/0/0/Acts. Last visited on 10-02-2017

under s 133 of the New Companies Act[9]. It is further provided that items contained in such financial statements shall be in accordance with the accounting standards.

6. *Secretarial Standards issued by the Institute of Company Secretaries of India* **(ICSI)**: ICSI is an autonomous body, which issues secretarial standards in terms of the provisions of the New Companies Act. So far, the ICSI has issued Secretarial Standard on "Meetings of the Board of Directors" (SS-1) and Secretarial Standards on "General Meetings" (SS-2). These Secretarial Standards have come into force w.e.f. July 1, 2015. Section 118(10) of the New Companies Act provide that every company (other than one person company) shall observe Secretarial Standards specified as such by the ICSI with respect to general and board meetings.
7. *Securities Contracts (Regulation) Act 1956 (SCR Act)* **:** The SCR Act 1956 controls the securities, areas for trading, licensing of stock exchanges, constitution and governance of stock exchanges and listing agreements. The Act has been amended several times, for instance in 2004 with the demutualization of stock exchanges, and latest in 2007.
8. *Depositories Act:* The Depositories Act 1996 ("Depositories Act") regulates the function of depository institutions in the Indian securities market. It made dematerialization of share certificates possible, which significantly lowered the time and risks associated with the share trading process.

REGULATORS

The three main agencies are SEBI enforcing securities law, the Ministry of Corporate Affairs (MCA) administrating the Companies Act, with the Company Law Board (CLB) as its enforcement arm, and the stock exchanges regulating the listing agreements.

SEBI

The Securities Exchange Board of India (SEBI) was set up in 1988 as an advisory body and was granted authority to regulate the securities market under the SEBI Act of 1992. SEBI's includes regulating business in stock exchanges and other securities markets, regulating financial intermediaries, prohibiting insider trading and fraud, promoting investors 'training

[9] The Companies Act 2013

and inspecting various regulated entities.[10] Various regulated entities.69 its stated objectives are to protect the interests of investors, to ensure the fairness, integrity and transparency of the securities market and to promote its development, to ultimately reach best international regulatory practices.[11]

SEBI has the power to issue subordinate legislation and is empowered to adjudicate on the violations found during inspections and investigations, or by the information provided by investors, intermediaries and media (Section 11(c), (1) SEBI Act, 1992). When a violation is found, directions can be issued, registration can be cancelled or suspended and monetary penalties can be imposed. The Securities Appellate Tribunals (SAT) with specialised domain knowledge can review's regulatory actions.[12]

SEBI's and powers have expanded over time, for instance under the SEBI (Amendment) Bill 2002, when SEBI was empowered to call for information from non-intermediaries and to seize documents for evidence, and in 2003 when Sebi was empowered to impose enhanced monetary and criminal penalties.[13]

MCA and CLB

The CLB is responsible for the enforcement of the Companies Act. According to Section 209A of the Companies Act the Registrar of Companies is empowered to inspect the Books of Accounts of companies with respect to their compliance to the Companies Act, the accuracy of and honouring of the rights of minority shareholders. In case of failure to file the accounts or if another violation is found, the CLB is authorized to initiate legal proceedings against the Company.

Stock exchanges

There are 24 stock exchanges active in India's capital market, which have grown rapidly over the last three decades, especially after India opened up to foreign investments. The set-up of the National Stock Exchange (NSE), an automated electronic exchange, substantially enhanced the transparency and liquidity of the stock exchanges and quickly gained upon the Bombay Stock Exchange (BSE). Stock exchanges are empowered to define additional rules and have

[10] Goyal 2005,
[11] Kaushik and Kamboh 2011
[12] Sarkar and Sarkar 2012.
[13] http://www.sebi.gov.in/web/home/list/1/1/0/0/Acts. Last visited on 13-02-2017

the responsibility of enforcing the listing regulations, but are not authorized to impose fines. (Section 4 and 9 SCR Act, 1956). Rules must be improved by Sebi, which is also the institution to take up enforcement cases identified by stock exchanges (Section 8 SRC Act, 1956).[14]

The efficiency of the regulators, more particularly SEBI and the CLB, will be discussed in Chapter 4 which data is provided of the performance of the regulators with respect to disposal of cases, imposed sanctions and the conviction rate.

DERIVATIVE SUITS AND CLASS ACTIONS

Derivative liability and class actions are briefly discussed because of their relevance for the effectiveness of private enforcement.

Derivative liability entails that a group of shareholders that represent a certain percentage (usually 10) of the shares can sue directly for damage caused to the company. In India derivative suits are allowed, but rarely used.[15] According to Khanna and Varottil (2012) the reason lies in the legal, judicial, economic and cultural environment in India. Class action rights lower the burden for groups of individuals to initiate legal proceedings.

The Companies Bill, 2009 introduced a specific clause (Clause 245) on class actions by shareholders. However this was met with stiff resistance from the industry which feared having to face a large increase in lawsuits from shareholders. The government as a response substantially limited the provision, making it less likely that it will result in greater enforcement of corporate law through increased shareholder actions. One important advantage of the provision is that it places shareholder actions within the jurisdiction of a specialised court with more knowledge in the field.[16]

PRINCIPLES OF CORPORATE GOVERNANCE

The fundamental or key principles of corporate governance are described below:

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[14] Raval 2011

[15] Doing Business 2012.

[16] Available at http://indiacorplaw.blogspot.in/2011/12/companies-bill-2011-class-actions.html Last vested on 14-02-2017

(i) Transparency

Transparency means the quality of something which enables one to understand the truth easily. In the context of corporate governance, it implies an accurate, adequate and timely disclosure of relevant information about the operating results etc. of the corporate enterprise to the stakeholders.

In fact, transparency is the foundation of corporate governance; which helps to develop a high level of public confidence in the corporate sector. For ensuring transparency in corporate administration, a company should publish relevant information about corporate affairs in leading newspapers, e.g., on a quarterly or half yearly or annual basis.

(ii) Accountability

Accountability is a liability to explain the results of one's decisions taken in the interest of others. In the context of corporate governance, accountability implies the responsibility of the Chairman, the Board of Directors and the chief executive for the use of company's resources (over which they have authority) in the best interest of company and its stakeholders.

(iii) Independence

Good corporate governance requires independence on the part of the top management of the corporation i.e. the Board of Directors must be strong non-partisan body; so that it can take all corporate decisions based on business prudence. Without the top management of the company being independent; good corporate governance is only a mere dream.

PRINCIPLES OF GOOD CORPORATE GOVERNANCE

Corporate governance relates to the manner in which the business of the organization is governed, including setting corporate objectives and an institution's risk profile, aligning corporate activities and behaviours with the expectation that the management will operate in a safe and sound manner, running day-to-day operations within an established risk profile, while protecting the interests of depositors and other stakeholders. It was defined by a set of relationships between the institution's management, its board, its shareholders, and other stakeholders. The key elements of sound corporate governance in a bank include:

a) A well-articulated corporate strategy against which the overall success and the contribution of individuals can be measured.

b) Setting and enforcing clear assignment of responsibilities, decision-making authority and accountabilities which are appropriate for the bank's risk profile.

c) A strong financial risk management function (independent of business lines), adequate internal control systems (including internal and external audit functions), and functional process design with the necessary checks and balances.

d) Corporate values, codes of conduct and other standards of appropriate behavior, and effective systems used to ensure compliance. This includes special monitoring of a bank's risk exposures where conflicts of interest are expected to appear (e.g., relationships with affiliated parties).

e) Financial and managerial incentives to act in an appropriate manner offered to the board, management and employees, including compensation, promotion and penalties. (i.e., compensation should be consistent with the bank's objectives, performance, and ethical values).

f) Transparency and appropriate information flows internally and to the public. Good Corporate Governance principles must be strictly adhered to by all the management groups working in various corporate environments.

GOOD CORPORATE GOVERNANCE PRINCIPLES

Principle	Details
Principle 1	Lay solid foundation for management, overseeing of all employees
Principle 2:	Structure the Board and the organisation to add value
Principle 3:	Promote ethical and responsible decision making
Principle 4	Safeguard integrity in financial reporting at all times
Principle 5	Make timely and balanced disclosures
Principle 6	Respect the rights of shareholders/stakeholders

Principle 7	Recognise and manage risks promptly and properly
Principle 8	Encourage and enhance performance at all levels
Principle 9	Remunerate fairly and responsibly according to ability
Principle 10	Recognise the legitimate interests of all stakeholders.