PRINCIPLES OF CORPORATE GOVERNANCE: THE INDIAN PERSPECTIVE

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Abstract:

Corporate governance is a very complex and controversial area of the law. Corporate governance has increased in prominence over the decades. It has been an area of speedy development especially after big corporate collapses, comprehensive measures were required to ensure adherence to good practice in corporate governance. Corporate or Corporation is derived from Latin term "corpus" which implies a "body". Governance implies directing the procedures and frameworks put for fulfilling partner desire.

The Principles are intended to help policymakers evaluate and improve the legal, regulatory, and institutional framework for corporate governance, with a view to support economic efficiency, sustainable growth and financial stability. A primary worry in the corporate governance deliberations is to balance the profit making objective of corporations against broader social responsibilities owed to the wider community. Good governance is essentially about effective leadership. Such leadership is characterized by the ethical values of responsibility, accountability, fairness and transparency and based on moral duties. The present paper goes for scrutiny on the various principles of corporate governance as embodied in the Indian legal system.

Corporate governance is beyond the realm of law. It stems from the culture and mindset of management, and cannot be regulated by legislation alone. Corporate governance is about ethical conduct in business. Ethics is concerned with the code of values and principles that enables a person to choose between right and wrong. Much more needs to be done to ensure the entrenchment of good governance standards, such as improving leadership.

Introduction

Corporate governance concerns the manner in which corporations are regulated and managed. Corporate governance has increased in prominence over the decades. It has been an area of speedy development especially after big corporate collapses, sweeping measures were required to ensure adherence to good practice in corporate governance.
Corporate or Corporation is derived from Latin term 'corpus' which implies a 'body'. Governance implies directing the procedures and frameworks put for fulfilling partner desire.

The purpose of corporate governance is to help build an environment of trust, transparency and accountability necessary for fostering long-term investment, financial stability and business integrity, thereby supporting stronger growth and more inclusive societies. The Principles are intended to help policymakers evaluate and improve the legal, regulatory, and institutional framework for corporate governance, with a view to support economic efficiency, sustainable growth and financial stability.[i]

A primary worry in the corporate governance deliberations is to balance the profit-making objective of corporations against broader social responsibilities owed to the wider community. The principles increase and constantly reinforce the trust placed in the company by present and future shareholders, creditors, customers & clients, employees, the public at large, the society, the community, the regulators and the suppliers. Through consistent implementation of these principles at all levels the Company's place in the capital markets will also be strengthened. Corporate governance has increased in prominence over the decades. It has been an area of speedy development especially after big corporate collapses, sweeping measures were required to ensure adherence to good practice in corporate governance. Corporate, performance and conduct impacts on every individual – often in very profound and significant ways. Corporate governance is a very complex and controversial area of the law.

In an age where capital flows worldwide, just as quickly as information, a company that does not promote a culture of strong, independent oversight, risks its very stability and future health. As a result, the link between a company's management, directors and its financial

reporting system has never been more crucial. As the boards provide stewardship of companies, they play a significant role in their efficient functioning.[ii]

Understanding Corporate Governance

Corporate governance is as old as the corporate form itself.[iii] Corporate governance involves 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 goals, objectives and monitoring performance are determined.

Early attempts to define the concept of corporate governance appear in the United Kingdom Cadbury Report (1992) and the South African King Report (1994), defining corporate governance as 'the system by which companies are directed and controlled'.[iv]
Good corporate governance is a key factor in underpinning the integrity, competence and efficiency of a company. Poor corporate governance can weaken a company's potential, can lead to financial difficulties and in some cases can cause long-term damage to a company's name and reputation.

Corporate governance is 'the framework of rules, relationships, affairs, systems and processes within and by which authority is exercised, prescribed and controlled in corporations'. It includes and encompasses the mechanisms by which companies, and those in control, are held to account.

Corporate governance refers generally to the legal and organizational framework within which, and the principles and processes by which, corporations are governed. It refers in particular to the powers, accountability and relationships of those who participate in the direction and control of a company. Chief among these participants are the board of directors, and management. There are aspects of the corporate governance regime that have an impact on the relationship between shareholders and the company.[v]

Effective corporate governance structures encourage companies to create value, through entrepreneurialism, innovation, development and exploration, and provide accountability and control systems commensurate with the risks involved.[vi]

Thus, the concept of 'corporate governance' began to adopt this new articulation of 'managing the corporation', with a central focus on the interrelationship between internal groups and individuals such as the board of directors, the shareholders in general meeting, employees, managing directors, executive directors, non-executive directors, managers, audit committees and other committees of the board. However, outside interests are also at stake; for example, those of creditors, potential investors, and consumers and the public or community at large.[vii]

If one takes into consideration recent developments, corporate governance could be defined as follows:

'The system of regulating and overseeing corporate conduct and of balancing the interests of all internal stakeholders and other parties - external stakeholders, governments and local communities – who can be affected by the corporation's conduct, in order to ensure responsible behaviour by corporations and to achieve the maximum level of efficiency and profitability for a corporation.[viii]

Moreover good governance is essentially about effective leadership. Leaders should rise to the challenges of modern governance. Such leadership is characterised by the ethical values of responsibility, accountability, fairness and transparency and based on moral duties. Responsible leaders direct company strategies and operation with a view to achieving sustainable economic, social and environmental performance.

Principles of corporate governance

The Principles are intended to be concise, understandable and accessible to the international community. On the basis of the Principles, it is the role of government, semi-government or private sector initiatives to assess the quality of the corporate governance framework and develop more detailed mandatory or voluntary provisions that can take into account country-specific economic, legal, and cultural differences. The Principles recognize the interests of employees and other stakeholders and their important role in contributing to the long-term success and performance of the company.[ix]

The Principles are developed with an understanding that corporate governance policies have an important role to play in achieving broader economic objectives with respect to investor confidence, capital formation and allocation.

Together, the body of corporate governance rules and practices therefore provides a framework that helps to bridge the gap between household savings and investment in the real economy. As a consequence, good corporate governance will encourage and reassure shareholders and other stakeholders that their rights are protected and make it feasible and possible for corporations to decrease the cost of capital and to facilitate their access to the capital market.[x]

Corporations pool capital from a large investor base both in the domestic and in the international capital markets. In this context, investment is ultimately an act of trust and faith in the ability of a corporation's management. When an investor invests money in a corporation, he looks forward to the board and the management to act as trustees and ensure and guarantee the safety of the capital and also earn a rate of return that is higher than the cost of capital. In this regard, investors expect management to act in their best interests at all times and adopt good corporate governance practices.[xi]

The Principles themselves are evolutionary in nature and are assessed and reviewed in light of significant changes in circumstances in order to maintain their role as a leading instrument for policy making in the area of corporate governance and the same can be discussed succinctly.

Effective corporate governance framework

Effective corporate governance requires a sound legal, regulatory and institutional framework that market participants can rely on when they establish their private contractual relations. This corporate governance framework typically comprises elements of legislation, regulation, self-regulatory arrangements, voluntary commitments and business practices that are the result of a country's specific circumstances, conditions, history and tradition. The

desirable mix between legislation, regulation, self-regulation, voluntary standards, etc., will therefore vary from country to country.[xii]

Division of responsibilities among different authorities

Corporate governance requirements and practices are typically influenced by an array of legal domains, such as company law, securities regulation, accounting and auditing standards, insolvency law, contract law, labour law, tax law etc. Corporate governance practices of individual companies are also often influenced by human rights and environmental laws. Under these circumstances, there is a risk that the variety of legal influences may cause unintentional overlaps and even conflicts, which may frustrate the ability to practice and pursue key corporate governance objectives. It is important that policy-makers are aware of this risk and take measures to limit it.[xiii]

Stock market regulation should support effective corporate governance.

Stock markets can play a meaningful role in enhancing corporate governance by establishing and enforcing requirements that promote effective corporate governance by their listed issuers e.g.
Clause 49 of the listing agreement mandates the listed companies to adhere to corporate governance standards.

Responsibilities - Supervisory, regulatory and enforcement Authorities

Supervisory, regulatory and enforcement responsibilities should be vested with bodies that are operationally independent and accountable in the exercise of their functions and powers.
Many countries have addressed the issue of political independence of the securities supervisor, regulator through the creation of a formal governing body.

The Securities and Exchange Board of India is a regulatory body having the basic function 'to protect the interests of investors in securities and to promote the development of, and to regulate the securities market and for matters connected therewith or incidental thereto' and therefore can enforce corporate governance norms to be complied with by all the companies who have listed their securities on the stock exchange.

Ensuring shareholders' rights

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

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 the board's accountability to the company and the shareholders. According to the existing law in India every company has to have independent directors accounting for at least a third of its board strength. Their main duty is to act as overseers outside the influence of the firm safeguarding the interest of the company.

Indian Perspective

Corporate Governance and Indian legal framework

The concept of corporate governance has been attracting public attention for quite some time in India. Progressive firms in India have voluntarily put in place systems of good corporate governance. The financial crisis in emerging markets has led to renewed discussions and inevitably focused them on the lack of corporate as well as governmental oversight.

The Committee[xiv] however felt that under Indian conditions a statutory rather than a voluntary code would be far more purposive and meaningful, at least in respect of essential features of corporate governance. In fact, Kumar Mangalam Birla Committee's recommendation culminated in the introduction of Clause 49 of the Listing Agreement to be

complied with by all listed companies. Practically most of the recommendations were accepted and included by SEBI in its new Clause 49 of the Listing Agreement in 2000, covering issues such as protection of investor interest, promotion of transparency, building international standards in terms of disclosure of information.

The Committee further observed that corporate governance has several claimants – shareholders and other stakeholders - which include suppliers, customers, creditors, the bankers, the employees of the company, the government and the society at large. The imperative for corporate governance lies not merely in drafting a code of corporate governance, but in practicing it.

The Committee recommended that the board of a company should have an optimum combination of executive and nonexecutive directors with not less than 50% of the board comprising the non-executive directors. In case, a company has a non-executive chairman, at least one-third of board should be comprised of independent directors and in case, a company has an executive chairman, at least half of the board should be independent. The committee for the first time introduced the Independent Directors who are non executive directors who apart from receiving director's remuneration do not have any other material pecuniary relationship or transaction with the company, its promoters, management or subsidiaries, which in the judgment of the board may affect their independence of judgment as they opined that "material pecuniary relationship which affects independence of a director" should be the litmus test of independence.

These and other mandatory recommendations culminated in the introduction of Clause 49 of the Listing Agreement to be complied with by all listed companies. Subsequently Clause 49 was amended in 2012 to introduce new corporate governance code to improve transparency and disclosure standards of listed companies in India.

In 2002 Government of India appointed Naresh Chandra Committee to examine and recommended drastic amendments to the law pertaining to auditor-client relationships and the role of independent directors. The committee extensively covered the statuary auditor-

company relationship, rotation of statutory audit firms/partners, procedure for appointment of auditors and determination of audit fees, true and fair statement of financial affairs of companies.

In 2002 SEBI constituted a Committee under the chairmanship of N.R. Narayana Murthy, chairman and mentor of Infosys, and mandated the Committee to review the performance of corporate governance in India and make appropriate recommendations. The Committee submitted its report in February 2003. The Committee focused on responsibilities of audit committee, quality of financial disclosure, requiring boards to assess and disclose business risks in the company's annual reports. The key mandatory recommendations focus on strengthening the responsibilities of audit committees; improving the quality of financial disclosures, including those related to related party transactions and proceeds from initial public offerings; requiring corporate executive boards to assess and disclose business risks in the annual reports of companies; introducing responsibilities on boards to adopt formal codes of conduct; the position of nominee directors; and stock holder approval and improved disclosures relating to compensation paid to non-executive directors.

Such and other committees were constituted by the Government of India and also by SEBI, to evaluate the adequacy of existing corporate governance practices and further improve these practices. They have outlined a series of voluntary recommendations to integrate best-in-class practices of corporate governance in listed companies which touches the four cornerstones of fairness, transparency, accountability and responsibility in managing the affairs of the company.

The final assent to Corporate Governance practices in the effective management of the company can be seen as introduction to new significant provisions introduced in the Companies Act, 2013 which seeks to achieve the objectives to encourage transparency, accountability and high standards of corporate governance; in form of Board composition and requirements for board members, Obligations and responsibilities of the Board, Role and responsibilities of independent Directors, women directors on the board, Ensuring shareholders' rights and participation at shareholders' meetings, Disclosure of Information, Transparency of the

Issuer's business, Principles of the Issuer's internal and external control, Audit Committee, General principles, types and criteria for setting remuneration, corporate social responsibility and mandatory compliance of Secretarial Standards issued by Institute of Company Secretaries of India as per Section 118 of Companies Act, 2013.

Conclusion

Corporate governance is beyond the realm of law. It stems from the culture and mindset of management, and cannot be regulated by legislation alone. Structures and rules are important because they provide a framework, which will encourage and enforce good governance; but alone, these cannot raise the standards of corporate governance. What counts is the way in which these are put to use.

It follows that the real onus of achieving the desired level of corporate governance, lies in the proactive initiatives taken by the companies themselves and not in the external measures like breadth and depth of a code or stringency of enforcement of norms. The extent of discipline, transparency and fairness, and the willingness shown by the companies themselves in implementing the Code, will be the crucial factor in achieving the desired confidence of shareholders and other stakeholders and fulfilling the goals of the company.

A corporation is a congregation of various stakeholders, namely, customers, employees, investors, vendor partners, government and society. A corporation should be fair and transparent to its stakeholders in all its transactions. This has become imperative in today's globalized business world where corporations need to access global pools of capital, need to attract and retain the best human capital from various parts of the world, need to partner with vendors on mega collaborations and need to live in harmony with the community. Unless a corporation embraces and demonstrates ethical conduct, it will not be able to succeed. Corporate governance is about ethical conduct in business. Ethics is concerned with the code of values and principles that enables a person to choose between right and wrong, and therefore, select from alternative courses of action.[xv]

Much more needs to be done to ensure the entrenchment of good governance standards, such as improving leadership. Indeed, there is a need for advocacy and awareness.

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