Concept Paper on National Corporate Governance Policy, 2012

Prepared by ICSI

1. PREAMBLE

This Concept Paper on National Corporate Governance Policy, 2012 prepared by ICSI is aimed at laying down an overarching policy framework for promoting good governance practices amongst corporates by instilling principles of good governance in the various statutes, regulations and policies of the Government as applicable to corporates.

Re-affirming that good corporate governance practices are *sine qua non* for sustainable business that aims at generating long term value to all its stakeholders and keeping in view the objective of encouraging the use of better practices through voluntary adoption, the Ministry issued a set of voluntary guidelines - the Corporate Governance Voluntary Guidelines, 2009, which not only served as benchmark for the corporate sector but also helped them in achieving the defined standards of corporate governance.

To achieve the objectives of this Policy, an institutional framework has been proposed to undertake, coordinate and oversee its implementation in cooperation with Central Ministries, sectoral regulators, enforcement agencies and other stakeholders.

Corporate governance mainly involves the establishment of structures and processes, with appropriate checks and balances that enable the Board, as collegian, to discharge their legal responsibilities in a manner which is beneficial to all stakeholders.

2. CORPORATE GOVERNANCE - Ancient Indian Connections

There is a great deal of similarity in the governance structures of the ancient kingdoms and modern corporations as is evident from our ancient text and scriptures.

Kautilya's Arthashastra maintains that for good governance, all administrators, including the king be considered servants of the people. Good governance and stability are completely linked. There is stability if leaders are responsive, accountable and removable. These tenets hold good even today.

Kautilya's fourfold duties of a king–

The substitution of the state with the corporation, the king with the CEO or the board of a corporation, and the subjects with the shareholders, bring out the quintessence of corporate governance, because central to the concept of corporate governance is the belief that public good should be ahead of private good and that the corporation's resources cannot be used for personal benefit.

Kautilya's fourfold duties of a king enshrined in Arthashastra are:

Raksha – literally means protection, in the business context it can be equated with the risk management aspect.

Vriddhi – literally means growth, in the corporate context it can be equated to stakeholder value enhancement

Palana – literally means maintenance/compliance, in the business context it can be equated to compliance of the law in letter and spirit.

Yogakshema – literally means well being and in Kautilya's Arthashastra it is used in context of a social security system. In the business context it can be equated to corporate social responsibility.

Kautilya asserts that "A king can reign only with the help of others; one wheel alone does not move a chariot. Therefore, a king should appoint advisors (as councilors and ministers) and listen to their advice."

"The opinion of advisers shall be sought individually as well as together [as a group]. The reason why each one holds a particular opinion shall also be ascertained."

Kautilya has emphasized on the imperatives of the king and his counselors acting in concert. Cohesion is key to the successful functioning of a board and the company it directs. A board that contributes constructively to sustainable success but does not compromise on the integrity and independence of the non-executive directors, is the most desirable instrument of good corporate governance.

"If the king and his counselors do not agree on the course of action, it spells future trouble, irrespective of whether the venture is crowned with success or ends in failure." There could be no stronger counsel relevant to modern day corporate governance structures for executive managements to heed the advice given by the non-executive independent colleagues on the board of directors.

Balancing the interests of the various stakeholders which is again at the core of good corporate governance, is highlighted in the Arthashastra and the other ancient texts. There is no prescription in the scriptures that the interests of only selected few need to be the concern of the king. This generic approach to an across-the-board welfare of all the citizens in the kingdom lends credence also to the modern theories of corporate accountability to a wider group of stakeholders, than merely to a single component thereof comprising shareholders.

3. EVOLUTION OF CORPORATE GOVERNANCE IN MODERN INDIA

The initiatives taken by 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 world over. On account of the interest generated by Cadbury Committee Report, 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.

Confederation of Indian Industry (CII) - Desirable Corporate Governance Code (1998)

CII took a special initiative on Corporate Governance, the first institutional initiative in Indian Industry, to develop and promote a code for Corporate Governance to be adopted and followed by Indian companies, whether in the private sector, the public sector, banks or financial institutions, all of which are corporate entities. The final draft of

the said Code was widely circulated in 1997 and in April 1998, CII released, a Desirable Corporate Governance Code.

Kumar Mangalam Birla Committee

The Securities and Exchange Board of India (SEBI) set up a Committee on May 7, 1999 under the Chairmanship of Kumar Mangalam Birla to promote and raise standards of corporate governance.

The recommendations of the Committee, led to inclusion of Clause 49 in the Listing Agreement in the year 2000. These recommendations, aimed at improving the standards of Corporate Governance, are divided into mandatory and non-mandatory recommendations. The said recommendations have been made applicable to all listed companies with the paid-up capital of Rs. 3 crores and above or net worth of Rs. 25 crores or more at any time in the history of the company. The ultimate responsibility for putting the recommendations into practice lies directly with the Board of Directors and the management of the company.

Naresh Chandra Committee

Naresh Chandra Committee was appointed in year 2002 to examine various corporate governance issues. Among others, the Committee was entrusted to analyse and recommend changes, if necessary, in diverse areas such as:

- the statutory auditor-company relationship, so as to further strengthen the professional nature of this interface;
- the need, if any, for rotation of statutory audit firms or partners;

- the procedure for appointment of auditors and determination of audit fees;
- restrictions, if necessary, on non-audit fees;
- independence of auditing functions;
- measures required to ensure that the management and companies actually present 'true and fair' statement of the financial affairs of companies;
- the need to consider measures such as certification of accounts and financial statements by the management and directors;
- the necessity of having a transparent system of random scrutiny of audited accounts;
- adequacy of regulation of chartered accountants, company secretaries and other similar statutory oversight functionaries;
- advantages, if any, of setting up an independent regulator similar to the Public Company Accounting Oversight Board in the SOX Act, and if so, its constitution; and
- the role of independent directors, and how their independence and effectiveness can be ensured.

N.R. Narayana Murthy Committee Report (2003)

In the year 2002, SEBI analyzed the statistics of compliance with the clause 49 by listed companies and felt that there was a need to look beyond the mere systems and procedures if corporate governance was to be made effective in protecting the interest of investors. SEBI therefore constituted a Committee under the Chairmanship of Shri N.R. Narayana Murthy, for reviewing the implementation of the corporate governance

code by listed companies and issued revised clause 49 based on its recommendations.

Dr. J J Irani Expert Committee Report on Company Law (2005)

In 2004, the Government constituted a committee under the Chairmanship of Dr. J.J. Irani, Director, Tata Sons, with the task of advising the Government on the proposed revisions to the Companies Act, 1956 with the objective to have a simplified compact law that would be able to address the changes taking place in the national and international scenario, enable adoption of internationally accepted best practices as well as provide adequate flexibility for timely evolution of new arrangements in response to the requirements of ever-changing business models. This committee recommended the formation of Limited Liability Partnership (LLP)and One Person Company in India.

Corporate Governance Voluntary Guidelines, 2009

The Ministry of Corporate Affairs issued the Corporate Governance Voluntary Guidelines, 2009. During the stakeholders consultation under the aegis of the National Foundation for Corporate Governance, the idea of developing voluntary guidelines on corporate governance found wide support from all stakeholders. These Guidelines were drawn from the report of the Task Force of CII on Corporate Governance headed by Shri Naresh Chandra and the recommendations of the Institute of Company Secretaries of India for Strengthening Corporate Governance Framework. These guidelines sought to provide corporate India a framework to

govern themselves voluntarily as per the defined standards of ethical and responsible conduct of business.

Guidelines on Corporate Governance for Central Public Sector Enterprises 2010

The Department of Public Enterprises (DPE) which is the nodal Department for laying down policies and guidelines concerning Central Public Sector Enterprises (CPSEs) has issued the Guidelines on Corporate Governance for Central Public Sector Enterprises 2010. These guidelines are applicable to both listed as well as unlisted public sector enterprises.

Corporate Social Responsibility Voluntary Guidelines, 2009

The Ministry of Corporate Affairs (MCA) also issued the Corporate Social Responsibility Voluntary Guidelines in December 2009. This was the first step towards mainstreaming the concept of Business Responsibilities. Through these Guidelines, the Ministry urged the business sector to adopt the principles contained in the Guidelines for responsible business practices. The document also said that "after considering the experience of the adoption of these Guidelines by the Indian corporate sector and consideration of relevant feedback and other related issues, the Government may initiate the exercise for review of these Guidelines and further improvement after one year".

National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business

Keeping in view the feedback from stakeholders, review of 2009 Guidelines was undertaken by the Guidelines Drafting Committee (GDC)

constituted by the Indian Institute of Corporate Affairs, resulting into the formulation of "National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business". These Guidelines were released by MCA on July 8, 2011.

The Guidelines have been articulated in the form of nine (9) Principles with the Core Elements. A suggested approach for adopting these guidelines, the steps for building a strategy for responsible business as well as business responsibility reporting framework, have been prescribed under the guidelines.

4. NEED FOR CONCEPT PAPER ON NATIONAL CORPORATE GOVERNANCE POLICY, 2012

Concept Paper on National Policy on Corporate Governance seeks to align and synergize the corporate governance norms prescribed by various regulatory bodies, benchmark good governance practices for the corporate sector to apply, encourage corporates to adopt the best governance practices leading to sustained growth of corporates embracing therein inclusive growth of the economy as a whole.

5. OBJECTIVES OF CORPORATE GOVERNANCE POLICY

The objectives of this policy are to provide guidance on inclusion of corporate governance practices to:

- Priority areas of reforms;
- inculcate a strong culture of core values, ethics, integrity, reliability and fair dealings amongst corporates;

- achieve a balance between providing protection to investors and fostering fair and efficient capital markets and confidence in capital markets;
- promote sustainable and inclusive growth of the corporate sector; and
- recognize that corporate governance is evolving in respect of -
    - Adequate disclosures and effective decision making
    - Transparency in business transactions;
    - Commitment to values and ethical conduct of business

This Policy is inclusive one and not intended to be prescriptive. The corporates are encouraged to consider this policy in developing their own corporate governance policy/codes.

6. PRINCIPLES OF CORPORATE GOVERNANCE POLICY

A. Board Composition

i. Size of the Board

The size of the Board should neither be too small nor too big. Experience indicates that smaller boards allow for real strategic discussion. At the same time, larger Boards provide the benefit of diverse experience and viewpoints.

The board should strike a balance of executive and non-executive directors.

The board should ensure that there is an appropriate balance of power and authority on the board. No one individual or block of individuals should be able to dominate the board's decision-making.

ii. Board Membership Criteria

All directors should be individuals of integrity and courage, with relevant skills and experience to bring judgment to bear on the business of the company.

iii. Diversity in Board

Every board should consider whether its size, diversity and demographics make it effective. Diversity applies to academic qualifications, technical expertise, relevant industry knowledge, experience, nationality, age and sex.

Diversity adds value, and adds to the bottom line.

Gender diversity is an important aspect of board diversity and companies should have women representation on the Boards.

iv. Board renewal - tenure of independent directors

Boards need to be regularly refreshed with new expertise, energy and experience. Independent directors should not have long tenure. A balance should be sought between continuity in board membership, subject to performance and eligibility for re-election

and the sourcing of new ideas through the introduction of new board members.

Every Company should frame a Board Renewal Policy of Independent Directors to facilitate their independence. The Policy may provide for maximum number of years a person could serve on the Board as an Independent Director.

v. *Separation of Office of Chairman and Chief Executive Officer*

The role and office of the Chairman and CEO should be separated to promote balance of power and to prevent unfettered decision making power with a single individual. Further, there should be a clear demarcation of the role and responsibilities of Chairman and Managing Director/Chief Executive Officer (CEO).

B. Board Committees

Board committees with formally established terms of reference, criteria for appointment, life span, role and function constitute an important element of the governance process and should be established with clearly agreed reporting procedures and a written scope of authority.

Committees are usually formed as a means of improving board effectiveness and efficiency in areas where more focused, specialized and technical discussions are required. These committees prepare the groundwork for decision-making and report at the subsequent board meeting. Committees enable better management of full board's time and allows in-depth scrutiny and focused attention.

The Board of Directors is ultimately responsible for the acts of the committee and therefore should define the committees' role and structure.

The Board should consider to constitute the following committees for better functioning:

1. Audit Committee
2. Shareholders/Investors Relations Committee
3. Remuneration Committee
4. Nomination Committee
5. Corporate Governance Committee
6. Risk Management Committee
7. CSR Committee

In addition to above committees the board may constitute other committees, depending upon the organization's size and other requirements.

C. Number of Directorships

Effective Board room performance of Directors is directly related to the time that they can devote. A Director should not hold a number of directorship positions at the same time. The number of companies in which an individual may become a director be restricted for all directors,

specifically if the person is Managing Director or Whole time director in the company.

D. Training of Directors

The companies should ensure that directors are inducted through a suitable familiarization process covering, inter-alia, their roles, responsibilities and liabilities. Efforts should be made to ensure that every director has the ability to understand basic financial statements and information and related documents/papers. There should be a statement to this effect by the Board in the Annual Report.

Besides this, the Board should also adopt suitable methods and training programmes to enrich the skills of directors from time to time.

E. Board Evaluation

The Board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors. The Board should state in the Annual Report how performance evaluation of the Board, its committees and its individual directors has been conducted.

F. Lead Independent Director

If the offices of Chairman of the Board and Chief Executive Officer are held by the same person, the Board should name a lead independent director to ensure a structure that provides an appropriate balance between the powers of the CEO and those of the independent directors.

The Lead Independent Director serves as an important liaison between the Board and Independent Directors.

Other roles of the lead independent director may include chairing meetings of non-executive directors and of independent directors, presiding over Board meetings in the absence of the chair, serving as the principal liaison between the independent directors and the chair, and leading the Board/director evaluation process.

Given these additional responsibilities, the lead independent director should be expected to devote a greater amount of time to Board service than the other directors.

G. Transparency & Disclosures

The corporate governance framework of an organization should ensure that timely and accurate disclosures are made on all its material information, including the financial position, performance, ownership, and governance of the company.

Disclosure should include, but not be limited to, material information on:

I. The financial and operating results of the company.

II. Company Profile

III. Corporate Governance Report

   a. Governance Structure and Policies

b. Ownership and shareholder’s rights including changes in control

c. Detailed information about the Board

d. Risk Management Framework

e. Existence of Internal Code of Conduct, Business Ethics and Whistle Blower Mechanism

f. Particulars of Internal Auditors

g. Secretarial Audit

h. Commitment to external initiatives

IV. Sustainability Report

1. Economic Performance
2. Environmental Performance
3. Social Performance
4. Value Statements
5. CSR Initiatives

V. Innovation Strategy / Research & Development

VI. Intangible Assets Reporting

Information should be prepared and disclosed in accordance with the standards of accounting - financial and non-financial.

Annual audit should be conducted by independent, competent and qualified auditors in order to provide an external and objective assurance to the board and shareholders that the financial and non-financial statements fairly represent the financial position and Environment, Social and Governance (ESG) performance of the company in all material respects.

H. Related Party Transactions (RPTs)

A related party transaction can present a potential or actual conflict of interest and may not be consistent with the best interests of the company and its shareholders.

The related party transactions should be managed in a transparent and legal manner so that these do not impose a heavy burden on the financial resources of a company, distort competition, affect optimum allocation of resources, waste public resources and lead to corrupt practices.

I. Shareholders Rights

Equity investors have certain rights. An equity share entitles the investor to participate in the profits of the corporation, with liability limited to the amount of the investment. In addition, ownership of an equity share provides a right to information about the corporation and a right to influence the corporation, primarily by participation in general shareholder meetings and by voting.

The shareholding body is made up of different types of shareholders like individuals and institutions and the responsibility for corporate strategy

and operations is typically placed in the hands of the Board of Directors and its' management team.

Basic shareholder rights which should be provided by every organization include the right to:

1) Secure methods of ownership registration;
2) Transfer ownership of shares;
3) Obtain relevant and material information about the corporation on a timely and regular basis;
4) Participate and vote in general shareholder meetings;
5) Elect and remove members of the board; and
6) Share in the profits of the corporation.

Responsibilities of Institutional Shareholders:-

- holding additional meetings with management specifically to discuss the specific shareholders concerns;
- meeting with the Chairman, senior independent director, or with all independent directors;
- making a public statement in advance of the AGM or an EGM; and
- submitting resolutions at shareholders' meetings;

J. Sustainability

The importance of businesses in improving the quality of life is well recognized. However, there is growing awareness that in an increasingly complex world, businesses also have significant and long-lasting impact

on people, planet and ability to sustain the levels of holistic development that is aspired to. This realization has also brought an increasing concern amongst all stakeholders, who are demanding that businesses of all types and sizes need to function with fairness and responsibility. Specifically, this calls for businesses being thoroughly aware and conscious of their social, environmental and economic responsibilities, and balance these different considerations in an ethical manner.

A key challenge for Board therefore is mainstreaming the sustainability issues. The corporate Boards must integrate strategy, sustainability and control (integrated governance), and establish the values and ethics that underpin sustainable practices.

It is, therefore, in the long-term interest of corporations to foster wealth-creating cooperation among stakeholders. The governance framework should recognize that the interest of the corporation is best served by serving the interests of all stakeholders and recognising their contribution to the long-term success of the corporation.

K. Ethics and Integrity

Good corporate governance is essentially about effective and responsible leadership, which calls for integrity, transparency and accountability. Leaders need to define strategy, provide direction and establish the ethics and values that will influence and guide practices and behaviour to achieve sustainable performance.

Companies should develop governance structures, procedures, practices and codes that ensure ethical conduct at all levels.

L. 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. Therefore, the Board members, jointly and severly, should assume following responsibilities:

- Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and all its stakeholders.
- Where board decisions may affect different shareholder groups differently, the board should treat all shareholders fairly.
- The board should apply high ethical standards. It should take into account the interests of all stakeholders.
- The board should fulfil certain key functions, including:
    - Reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans; setting performance objectives; monitoring implementation and corporate performance; and overseeing major capital expenditures, acquisitions and divestitures.

- Monitoring the effectiveness of the company's governance practices and making changes as needed.
- Selecting, compensating, monitoring and, when necessary, replacing key executives and overseeing succession planning.
- Aligning key executive and board remuneration with the long term interests of the company and its shareholders.
- Ensuring a formal and transparent board nomination and election process.
- Monitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions.
- Ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for risk management, financial and operational control, and compliance with the law and relevant standards.
- Overseeing the process of disclosure and communications.

- The board should be able to exercise objective independent judgement on corporate affairs.

- The mandate, composition and working procedures of committees of the Board should be well defined and disclosed by the board.

- Board members should commit themselves effectively to their responsibilities.

In order to fulfil their responsibilities, board members should have access to accurate, relevant and timely information.

7. CORPORATE GOVERNANCE IN SMALL AND MEDIUM ENTERPRISES

The Small and Medium Enterprises (SMEs) play a catalytic role in the development process of any economy as they constitute a major part of the industrial activity. The contribution of SMEs in the development of Indian economy has been significant, both in terms of contribution to GDP and creation of employment opportunities. In India, SME sector is the second largest employer, after agriculture.

Reasons for SMEs to implement corporate governance principles:

- Good governance practices pave the way for companies to grow or attract additional investors as an alternative to raising capital through borrowing from banks at high cost. SMEs may adopt the Limited Liability Partnership mode of business.

- Sound governance practices lead to improved internal control systems, lesser probability of frauds, better accountability and higher profitability.

- Good Corporate governance practices helps in reducing conflicts between business owners and management.

Raising capital become easier for SMEs implementing good corporate governance practices.

In order to develop a culture of good corporate governance amongst small and medium size organizations, it is necessary that each business enterprise should develop 'Corporate Governance-Best Practices' manual for board processes, procedures and formats which may include, inter-alia, the profile of board positions; recruitment, selection, induction, training processes; conduct of board meetings; dealing with conflict of interests, disclosures, accounting and reporting requirements; evaluating board members; remuneration and re-nomination, CSR/sustainability issue.

Seminars, workshops, training programmes, director orientation programmes etc. should be conducted by the Industrial bodies and association to propagate corporate governance norms, compliance culture, social and environmental discipline among SMEs.

The Corporate Governance Principles enumerated herein may be applied by SMEs to the extent possible.

8. OVERSIGHT OF IMPLEMENTATION AND COORDINATION BETWEEN REGULATORY AGENCIES

To achieve the objectives of this Policy, an institutional framework has been proposed to undertake, coordinate and oversee its implementation in cooperation with Central Ministries, sectoral regulators, enforcement agencies and other stakeholders.

9. REVIEW OF NATIONAL CORPORATE GOVERNANCE POLICY, 2012.

Review of the National Corporate Governance Policy, 2012 will be undertaken once in every three years.