CORPORATE GOVERNANCE

&

ROLE OF INDEPENDENT DIRECTORS

INTRODUCTION AND HISTORY

The root of the word 'Governance' is from 'GUBERNATE' which means to steer i.e. to direct the course & the word Corporate Governance would literally means – to direct the course of the corporate.

People are generally having a misconception that the concept of Corporate Governance has evolved with the negative happenings in the corporate world, but the fact is this that the concept of Corporate Governance is as old as the society. Kautilya's Artashastra has mentioned the same and stated that all administrators including the King were to be considered as servants of people to maintain good governance.

Kautilya elaborates on four fold duty of a King as: -

i. raksha
ii. vridhi
iii. palana
iv. yogakshema –Social Security System (in modern times Corporate Social Responsibility)

In the modern times its history can be traced way back from mid 1970's and the USA enacted an act on the review of system of Internal Control viz. The Foreign Corrupt Practices Act, 1977. Also in 1979 US Securities Exchange Commission prescribed the mandatory reporting.

VARIOUS COMMITTEES

Many committees have been *inter alia* formed to help out regulatory authorities in raising standards of Corporate Governance. Some of the popular Committees were: -

At International Level: -

- The Cadbury Report – 1992
- The Greenbury Report - 1995
- The Hampel Report - 1998
- The Turnbull Report
- Higgs Report
- Smith Report
- Tyson Report
- Combined Code on Corporate Governance (2008)

In India: -

- CII's Desirable Corporate Governance Code
- Kumara Mangalam Birla Committee
- Task Force on Corporate Excellence Through Governance – by MCA
- Naresh Chandra Committee
- N.R. Narayana Murthy Committee
- Dr. JJ Irani Expert Committee

DEFINITION OF CORPORATE GOVERNANCE

So many committees (Both at National and International Level) have been formed and all gave their opinion and defined it in best suited way like –

According to Cadbury Committee – "It is the system by which companies are directed and controlled".

According to James D. Wolfesohn, President of World Bank – "It is about prompting fairness, transparency and accountability".

So it can be summed up that it is the code of business in accordance with the stakeholders desires to achieve the desired goals while confirming to the basic rules of the society embodied in law and local customs.

ELEMENTS OF GOOD CORPORATE GOVERNANCE

- Role and Powers of Board
- Legislation
- Board Environment
- Board Appointment
- Board Meetings
- Code of Conduct
- Financial and Operational Reporting
- Monitoring the Board Performance
- Risk Management
- Active Participation of Stakeholders

Components of Corporate Governance

MODELS OF CORPORATE GOVERNANCE

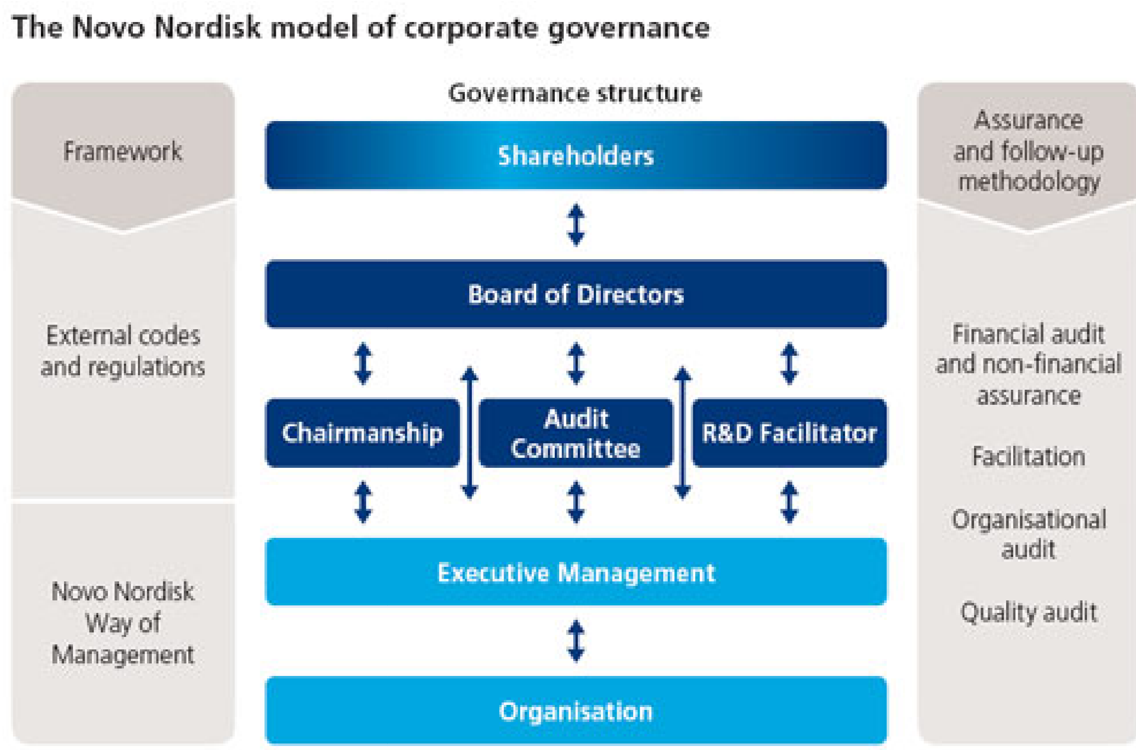
There are many different models of Corporate Governance around the world. These differ according to the variety of capitalism in which they are embedded. . The liberal model that is common in Anglo-American countries tends to give priority to the interests of shareholders. The coordinated model that one finds in Continental Europe and Japan also recognizes the interests of workers, managers, suppliers, customers, and the community. Each model has its own distinct competitive advantage.

Anglo-American Model: -

The liberal model of corporate governance encourages radical innovation and cost competition, whereas the coordinated model of corporate governance facilitates incremental innovation and quality competition. However, there are important differences between the U.S. recent approach to governance issues and what has happened in the UK. In the United States, a corporation is governed by a board of directors, which has the power to choose an executive officer, usually known as the Chief Executive Officer. The CEO has broad power to manage the corporation on a daily basis, but needs to get board approval for certain major actions, such as hiring his/her immediate subordinates, raising money, acquiring another company, major capital expansions, or other expensive projects. Other duties of the board may include policy setting, decision making, monitoring management's performance, or corporate control.

The board of directors is nominally selected by and responsible to the shareholders, but the bylaws of many companies make it difficult for all but the largest shareholders to have any influence over the makeup of the board; normally, individual shareholders are not offered a choice of board nominees among which to choose, but are merely asked to rubberstamp the nominees of the sitting board. Perverse incentives have pervaded many corporate boards in the developed world, with board members beholden to the chief executive whose actions they are intended to oversee. Frequently, members of the boards of directors are CEOs of other corporations, some see as conflict of interest sons to deviate from the sound rule, they should be able to convincingly explain those to their shareholders.

<u>The Novo Nordisk Model: -</u>



LEGISLATIVE FRAMEWORK OF CORPORATE GOVERNANCE IN INDIA

The heart of good Corporate Governance is transparency, disclosure, accountability, and integrity. For achieving the better and best result the things need to come in from within not by the force or pressure. Good Governance flows from the ethical business practices even when there is no legislation. It is not just the legal concept, however one cannot rely that all will be enlightened at large in corporate and so there lies the need of the legislative framework. In Indian context there are many regulatory forces which look and take care that Governance is achieved upto a minimum level.

Some of the major regulatory forces that foster the same are: -

- SEBI Guidelines
- Companies Act
- Listing Agreement

BOARD

Structure: - In India One Tier Structure is followed

Size: -

Under Companies Act: - u/s 252 every public company shall have minimum three numbers of directors and maximum no. directors that a company have is twelve (however this number can be increased with the approval of Central Government).

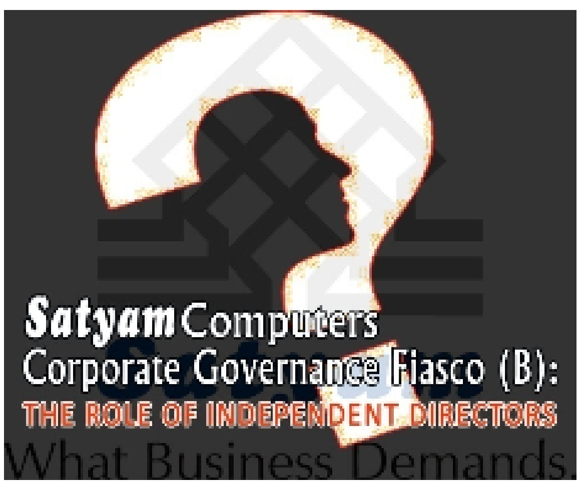
Listing Agreement is silent on the matter of size of Board.

Composition: -

Companies Act: - it does not stipulate anything in this regard but u/s 269 mentions of that a public company must have a MD or WTD, if it's Paid-up Capital is Rs. 5 Crores or more.

Under Listing Agreement: -

- Among the total number of directors atleast 50% should be non-executive directors.
- If the Chairman of Board is non-executive director then atleast one-third of Board should comprise of Independent Director else they should be atleast 50% in number but in such case the chairman should not be one among the promoters nor should be related to promoters.



The term Independent Director is very important to be understood here, Independence is not the physical state of the person but the mental state of the person and more specifically as per the Listing Agreement he is one who: -

- **Apart from receiving directors remuneration is not related to promoters, in transaction with company, other directors, subsidiaries and other associates so as to which may affect his independence,**
- **Not related to promoters, person occupying the management seat, or any other who is just one level bellow the board,**

- **He has not been an executive of company for immediately preceding three years,**
- **Not a partner or an executive or was a partner or an executive during the preceding three years, of any Statutory Auditor firm, Internal Auditor, Legal Firm, Consulting Firm materially associated with the company,**
- **Not a material supplier, service provider or customer or a lessee or lessor of the company,**
- **Not a substantial shareholder i.e. does not hold or owe two percent or more block of voting rights,**
- **Should not be less than 21 years of age.**

RESPONSIBILITIES OF INDEPENDENT DIRECTORS

To execute their role, independent directors, have similar responsibilities to those of other directors. The fiduciary duties of care, diligence and acting in good faith apply equally to independent directors as to other directors. In view of faith imposed on them by various agencies they are more bound to execute their functions with impartiality. It is necessary for the independent directors to:

a. prepare themselves thoroughly for the meeting
b. be objective in forming sound decisions relating to the company and its business
c. be open minded, free and frank in expressing their opinions and at the same be willing to engage in meaningful debates
d. be committed to decisions made as a Board,
e. continuously seek information both from within and if required outside professional knowledge to keep abreast with the latest developments in the areas of the company's operations
f. be informed on laws and regulations influencing their functioning as directors
g. Utilize the expertise they possess to the good advantage of the company

A final point on their responsibility, and indeed the whole boards, is a requirement to act in the larger genuine interest of true growth & development of the company.

- ***Why is he required?***
  - Role in Corporate Governance
  - Independent Judgment
  - Technical Expertise
  - Investor Confidence

- ***How effective is the Independent Director?***
  - Is he really independent?
  - Can he really demand information or is he kept in the dark?
  - Is he on the Board of too many companies?
  - How effective is a dissenting director?

Number of Directorship: -

Companies Act: - as per section 275, a person can not hold office in more than 15 companies at a time.

AS per Listing Agreement: - there is no such stipulation but it restricts a director from being member in more than 10 mandatory committee or can not act as chairman of more than 5 of such mandatory committee.

There are two Mandatory Committees viz. Audit Committee & Shareholders Grievance Committee.

Board Meetings: -

Companies Act: - as per section 285, atleast once in every three months and atleast four such during a year.

Committees: -

Companies Act makes it mandatory for the Public Company to have an Audit Committee be formed when its paid-up capital is greater than or equal to Rs. 5 Cr.

As per Listing Agreement all listed companies need to have following two committees and are termed as mandatory committee viz.: -

- Audit Committee: - Every company with the paid-up capital of more than 3 Cr or net worth greater than Rs. 25 Cr during any time in the history of the co. and also stipulates that all the members of the audit committee must be financially literate and one of them must have accounting expertise.
- Shareholders Grievance Committee.

As per the listing agreement there is no compulsion for the company to have a Compensation Committee but it also states that no company can issue ESOP/ESOS or Sweat Equity shares without following the terms and conditions as laid down and at the price and also the other stipulations as laid down and directed by it.

DISCLOSURE AND TRANSPARENCY: IN TERMS OF COMPANIES ACT, 1956.

Companies Act under the charge of Ministry has framed a structure of reporting to the jurisdictional ROC Centre, where earlier the forms made all disclosures in the paper mode but now in the 21st Century the MCA is moving towards the maintainace of all the documents and for its reporting moving to a environment of paperless filling by introducing the system of e-filling. Through the application of the Information Technology the government want to achieve the SMART (Simple, Moral, Accountable, Responsive, Transparent) Governance.

DISCLOSURE UNDER LISTING AGREEMENT

As per Listing Agreement there are various clauses through which the Stock Exchanges monitors and reviews the governance work of the corporate. Some of the various clauses of listing agreement in this regards are as follows: -

Clause 19: - Companies need to inform the stock exchanges about the Board meeting in which proposal for buy – back of securities is to be considered atleast 7 days in advance.

Clause 20 & 22: - Companies need to inform about the decisions and resolutions so adopted whether ordinary business item or special business item, within 15 minutes of the closure of meeting by letter or fax.

Clause 30: - Company need to promptly inform the stock exchange about any change in composition of Board and Auditors.

Clause 35: - Company need to inform Stock exchange about shareholding pattern for every quarter within 21 days from end of quarter.

Clause 36: - Company need to inform the stock Exchange about all the material events such as strikes, Lock-outs, closure on account of power cut etc.

Clause 41: - Publication of Financial results of the company.

Clause 49: - This is also a code in itself for Good Corporate governance.

Clause 51: - Companies need to submit all information's to stock exchange that it will and has submitted to others.