



भारतीय प्रबंध संस्थान बेंगलूर  
INDIAN INSTITUTE OF MANAGEMENT  
BANGALORE

**WORKING PAPER NO: 447**

**Strengthening Corporate Governance in India  
A Review of Legislative and Regulatory Initiatives in 2013-2014**

**N. Balasubramanian**

*Visiting Professor*

*Centre for Corporate Governance and Citizenship,  
Indian Institute of Management Bangalore,  
Bannerghatta Road, Bangalore-560076*

[laba@iimb.ernet.in](mailto:laba@iimb.ernet.in)

2014 JUNE REVISION

# Strengthening Corporate Governance in India

---

## A Review of Legislative and Regulatory Initiatives in 2013-14

**“Bala” N Balasubramanian**

**23 June 2014**

The passing of the long awaited Companies Act in 2013 is probably the single most important development in India’s history of corporate legislation, next only to the monumental Companies Act 1956 which it replaces. While significant improvements have been effected in required standards of corporate governance, there is also some concern regarding overly increasing compliance and regulatory costs and efforts for companies as well as their independent directors. Among the major provisions of the Act are those of restraining voting rights of interested shareholders on related party transactions, recognition of board accountability to stakeholders besides shareholders, and extension of several good governance requirements to relatively large unlisted corporations. The author (Adjunct Professor at the Indian Institute of Management Ahmedabad, and Founding and former Chairman, and Advisor of the Centre for Corporate Governance and Citizenship at the Indian Institute of Management Bangalore) acknowledges with gratitude the very helpful comments and suggestions of Afra Afsharipour, Sharad Abhyankar and Nawshir Mirza. © 2014, N Balasubramanian

# Strengthening Corporate Governance in India

## A Review of Legislative and Regulatory Initiatives in 2013-14

---

One small step for [a] man, one giant leap for mankind  
- Neil Armstrong, first man on moon in 1969

Have promises to keep, and miles to go before I sleep  
- Robert Frost

---

In Indian corporate history, there is more than an even chance that 2013 will go down as a watershed year in terms of corporate governance reforms (Initiatives). It was the year a path breaking new Companies Act (Act) found its way in to the statute book; following this, 2014 marked far reaching reforms in regulatory provisions through the Stock Exchange (SE) Listing Agreement (LA) in respect of publicly traded corporations as mandated by the capital market regulator, Securities and Exchange Board of India (SEBI). Passing of some legislation even as important as a Companies Act or changes in mandatory listing requirements are in the normal course no cause for major approbation; but then, these Initiatives were no ordinary cosmetic measures but major structural shifts for the better as will presently be seen, although in the ongoing quest for excellence, there are issues still remaining to be addressed. The question is whether the legislative and regulatory intent would actually translate in to effective and time bound enforcement; on this, based on track record, regrettably, the jury is still out, although some recent signs of regulatory activism do offer hope for a measure of cautious optimism.

The paper is organized as follows: section I briefly documents the evolution of corporate governance in the country; section II sets out how some of the key governance objectives are

sought to be addressed by the Initiatives; and section III concludes highlighting some areas that still need further strengthening.

## I

### How did we get here?

History of sorts was made late on the evening of 8<sup>th</sup> August 2013 when the *Rajya Sabha* (India's Upper House of Parliament) passed the Companies Bill, 2012; *Lok Sabha* (the Lower House) had passed it earlier in December 2012. With this, India now has "a modern legislation for growth and regulation of corporate sector in India," which is expected to "facilitate business-friendly corporate regulation, improve corporate governance norms, enhance accountability on the part of corporates / auditors, raise levels of transparency and protect interests of investors, particularly small investors."<sup>1</sup>

Corporate governance requirements in India were wholly in the legislative domain until the early nineties when an independent capital markets regulator, Securities and Exchange Board of India (SEBI) was set up by an Act of Parliament. The earliest piece of corporate legislation was the Joint Stock Companies Act of 1866 followed by several amendments and replacement legislations, largely following the developments in the UK. The first comprehensive overhaul of corporation law was undertaken in the years immediately following political independence of the country from British rule and led to the enactment of the Companies Act of 1956; this was the 'mother' Act (with numerous amendments over the years) that was in force till the 2013 legislation replaced it. Until SEBI came on the scene, matters uniquely concerning publicly traded companies were dealt with under the Companies Act and the Securities (Contracts) Act and Capital Issues Control Regulations, administered under the aegis of the government. A separate Stock Exchanges Division in the Finance Ministry oversaw the functioning of stock exchanges in India (with a chequered history<sup>2</sup> of their own) while competition and fair trading

---

<sup>1</sup> MCA (2013)

<sup>2</sup> Illustratively, Shroff (1962), BSE (1968), Barua and Verma (1993), and Basu and Dalal (2001)

were governed by the Monopolies and Restrictive Trade Practices Act, with issues relating to corporate ownership and foreign involvement in securities trading being dealt with by the Foreign Exchange Regulation Act. Over the years, these statutes underwent revisions to reflect policy changes of the government.

The Companies Act 1956 was indeed a voluminous document, arguably the largest piece of legislation in the world that sought to intervene and control corporate behaviour in tune with the left-of-centre political philosophy of the then government.<sup>3</sup> There had been a long felt need for a company legislation that was shorter, more comprehensible, and most importantly, in tune with the economic environment of relative free market conditions the country was gradually moving towards. The first step was initiated by the government in 2004 with the issue for public comment of a *Concept Paper*<sup>4</sup> by the Department of Company Affairs (as it was then called) that set out the broad outlines of the principles that should guide drafting of the new legislation.

The years just preceding and during the first decade of the new millennium were also eventful in terms of corporate crime and misdemeanours around the world and in India. A number of high profile corporations in the US, among them Enron, WorldCom, Global Crossing and Bear Sterns, in the UK and the Continent were making media headlines for the wrong reasons of governance failure and executive fraud on their companies and shareholders. These were followed by the sub-prime-mortgages-triggered financial meltdown globally during 2008-09 that consumed and impaired heritage institutions like Lehman Brothers, AIG, Fanny Mae, Freddie Mac, Countryside, Washington Mutual, Wachovia, all in the US, and many others elsewhere; the world was still struggling in 2013 to come out of the downturn and recession these firms were responsible for setting off, with trillions of dollars of public funds having had to be defrayed in stemming the rot and containing the fallouts. India also reported the biggest corporate fraud at Satyam perpetrated over several years only to explode in 2009. These

---

<sup>3</sup> Managerial remuneration, for example, in case of company directors was severely restricted and made subject to several prescribed overall and category-wise ceilings with any deviations having to be approved by the government

<sup>4</sup> DCA (2005)

developments also led to the appointments of various committees, among them those under the chairmanship of Sanjeeva Reddy<sup>5</sup> (1999), Naresh Chandra<sup>6</sup> (2004) and Jamshed Irani<sup>7</sup> (2005) by the government, Kumar Mangalam Birla<sup>8</sup> (1999), and Narayana Murthy<sup>9</sup> (2006) by SEBI, generally to recommend measures to improve corporate governance, investor protection, independent audit, and so on. Earlier in 1998, the Confederation of Indian Industry, the leading industry association had also come out with a voluntary code<sup>10</sup> for its members, the first self-improvement advisory on the subject from industry.

After considering the feedback from the public,<sup>11</sup> a Companies Bill was drafted by the Ministry in 2009 largely based on the recommendations of the Irani Committee but could not be processed through parliament in time before its term was over, and hence it had lapsed. It was presented again with further improvements in 2011, and after due parliamentary committee scrutiny process, finally entered the statute book in 2013.

Meantime, in January 2013, SEBI had issued a Consultation Paper with its draft proposals for changes in governance requirements applicable to listed companies, largely based on the proposed legislative provisions in the Act and in some cases incorporating further improvements.<sup>12</sup> Having gone through due consultation process in the first quarter of 2013,<sup>13</sup> and after issue of secondary legislation under the Companies Act, SEBI's governance reforms in respect of listed companies were announced in 2014.<sup>14</sup>

---

<sup>5</sup> MCA (1999)

<sup>6</sup> MCA (2004)

<sup>7</sup> MCA (2005)

<sup>8</sup> SEBI (1999)

<sup>9</sup> SEBI (2003, 2006)

<sup>10</sup> CII (1997)

<sup>11</sup> Balasubramanian (2004) is a representative critique of the Concept Paper, prepared as a backgrounder for a Round Table discussion on the subject at the Indian Institute of Management Bangalore, held on 4 December 2004, under the auspices of its Centres for Public Policy, and Corporate Governance and Citizenship

<sup>12</sup> SEBI (2013), *Consultative Paper on Review of Corporate Governance Norms in India*, Securities and Exchange Board of India, Jan, 4; [www.sebi.gov.in/cms/sebi\\_data/attachdocs/1357290354602.pdf](http://www.sebi.gov.in/cms/sebi_data/attachdocs/1357290354602.pdf)

<sup>13</sup> Balasubramanian (2013), is a representative response to the Consultation Paper

<sup>14</sup> SEBI (2014)

## II

### Key Initiatives of 2013-14

Although the Act has brought in a number of improvements impacting corporations in all their lifecycle stages commencing from their incorporation through their operating span to their eventual demise, the scope of this paper is limited to their board-centric governance aspects; other improvements may be mentioned peripherally only to the extent they help clarify or set the context in perspective. The same caveat applies to the LA Initiatives as well.

These initiatives are discussed under five thematic categories: those relating to (a) corporations and society, (b) absentee shareholder primacy and protection, (c) boards and their processes, (d) disclosure and transparency in reporting, and (e) unlisted company governance.

#### Corporations and Society

Two key themes relating to business and society emerge out of the Initiatives: the first concerns obligations relating to corporate social responsibility (CSR) and the second concerns recognition of stakeholders' interests in corporate governance.

##### ***Corporate Social Responsibility***

The positioning of the business corporation in the larger frame of society has been a subject of contentious debate for decades with views ranging from total denial of any corporate responsibility to society as long as operating under prescribed law<sup>15</sup> through to overriding accountability to society on pain of losing the sanction and licence to operate,<sup>16</sup> with several

---

<sup>15</sup> Friedman (1962, p. 138)

<sup>16</sup> Bowen (1953, p. xi)

shades of mix in between.<sup>17</sup> It is fair to observe, though, that in recent decades, there have been signs of a measure of corporate recognition of some responsibility towards society, as evidenced by increasing number of corporations reporting on their sustainability Initiatives. The acceptance of social responsibility is arguably embedded in the Indian business *psyche*<sup>18</sup> although modern day competitive commercialism may have whittled it down in numerous instances; this inherent conviction is reflected in a large number of business people voluntarily engaging in some form of social response based on their perceptions and convictions, even while aggressively pursuing profit objectives and personal gain.

In the arena of government intervention in this domain, virtually every country around the world has a record of activism in varying degrees: this manifests itself in *public interest* legislation, gentle prodding through guidance for voluntary adoption, or specific mandatory directions imposing an obligation to socially respond which Friedman deemed as equivalent to taxing business. India has an impressive history of measures in the first two categories<sup>19</sup> and with the 2013 Initiatives has also moved towards the third, perhaps the first country to legislate prescriptive social responsibility on corporations.

The Act now requires every company having at least a net worth of Rs 5,000 mn, or sales revenue of Rs 10,000 mn, or a net profit of Rs 50 mn during any year to do the following:

- Spend in every financial year, at least two per cent. of the average net profits of the company made during the three immediately preceding financial years, on CSR activities
- Give preference in spending to the local area and areas around it where it operates
- In case of failure achieve the spend target, the Board shall, in its annual report to shareholders, explain the reasons why the required obligation to spend was not met
- The board shall appoint a Corporate Social Responsibility Committee of three or more directors, at least one of them being independent; the Committee, its composition having to be reported in the directors' report to shareholders, is required to:

---

<sup>17</sup> Robé (2012)

<sup>18</sup> Mitra (2007),

<sup>19</sup> Measures that legislate minimum standards of pollution, emission, and effluents, work place safety and security, disclosure of contents and health hazard details on packages, and restrain or completely ban sex-determination tests and advertising content on products like liquor are some examples of the first category of Initiative s. Voluntary CSR Guidelines and comply-or-explain kind of requirements belong to the second category



- formulate and recommend to the Board, a Corporate Social Responsibility Policy which shall indicate the activities to be undertaken by the company
- recommend the amount of expenditure to be incurred on the activities; and
- monitor the Corporate Social Responsibility Policy of the company from time to time

In addition, the board's annual report to the shareholders is required to provide "details about the policy developed and implemented by the company on corporate social responsibility Initiatives taken during the year."<sup>20</sup>

Not only have the government mandated this spending requirement but have gone further in suggesting what kind of activities it would like to see covered within the ambit of CSR activities. Although Schedule VII of the Act (Exhibit 3) uses the permissive "may" while enumerating these activities, it is clear from a reading of the section<sup>21</sup> that in this case *may* actually means *shall*, and the only freedom that companies have is the choice of activities from among the listed items that they believe would serve their companies' mission and business objectives or values.

There are several questions that arise with regard to this Initiative: Whether at all CSR ought to be legislated? Even so, shouldn't the spending discretion have been left to the shareholders and boards of the companies with a reporting requirement rather than prescribing the acceptable (to the government) options? Why should activities undertaken in pursuance of normal course of business be excluded<sup>22</sup> if they do otherwise meet prescribed CSR criteria? And what is the rationale for the 2% minimum spend? Even more importantly, if business corporations are deemed to have a social obligation, is there any justification to limit the charge only to profit

---

<sup>20</sup> Section 134 (3) (o) and 135 (3) of the Act

<sup>21</sup> Section 135 (3) (a) of the Act also provides: "formulate and recommend to the Board, a Corporate Social Responsibility Policy which **shall** indicate the activities to be undertaken by the company as specified in Schedule VII;" and before this, Section 135 (3) begins with: "The Corporate Social Responsibility Committee **shall**," and these taken together would suggest the listed activities are in fact mandatory rather than an illustrative prescribing the contours of CSR applications that the government desires companies to pursue [emphasis supplied]

<sup>22</sup> Rule 1 (e) and the first proviso to Rule 6 of the Companies (Corporate Social Responsibility Policy) Rules 2014 contain this exclusion, the import of which is not apparent. Internalising good CSR principles as part of a company's operating and decision making processes, one would have thought, was a desirable objective. A more detailed discussion is available in my 2005 article

making companies? Why not treat this as an expense of doing business rather than contingent on profit-making?

There is also potential danger of the CSR provisions in the Act encouraging companies to indulge in mandated philanthropy masquerading as discharge of responsibility towards society. There is more to CSR than just philanthropy, important and welcome as the latter is in its own right.

It is instructive to note that the original Companies Bill 2009 (the predecessor to the current Act) did not have any provisions relating to CSR. It was the parliamentary Standing Committee reviewing the bill that sought introduction of such provisions. Responding to the Committee, the then Secretary to the Government at the Ministry of Company Affairs mentioned:

“This is the first time and historically it may be the first time in the world – [is] that we are putting the Corporate Social Responsibility which the Chairman [of the Committee] directed to us. We are putting it in the law itself that every company beyond the certain limit should have a corporate social responsibility policy. This is something we cannot mandate beyond that, but we are making a provision in the law itself.”<sup>23</sup>

These observations indicate these were tentative first steps in according statutory recognition to CSR obligations of business corporations which had till now been thought of as not entirely being in the legitimate domain of the board and the directors without the specific concurrence of shareholders,<sup>24</sup> or unless justifiable in the business interests of the corporation. The government was also under some pressure to include the eventual provisions in the Act since it had already issued *voluntary guidelines* on corporate social responsibility (virtually on a “comply or explain” basis).<sup>25</sup> It is perhaps fair to conclude that compliance with these provisions will be observed carefully in their implementation in practice and amendments introduced as considered necessary.

---

<sup>23</sup> SCF (2010, paragraph 9.45, p. 159). The quote is verbatim and no attempt has been made to correct any grammatical errors in transcription

<sup>24</sup> It may be recalled that many companies, among them the Tata Group companies, had sought and obtained such concurrence from their shareholders for their CSR activities or included such activities in their Articles as being within the power of their company boards

<sup>25</sup> MCA (2009, p.10)

## ***The Stakeholder Issue***

Closely allied to the CSR debate has been the wider issue of corporate accountability to a range of relevant stakeholders that has been the subject of raging controversy in governance literature. Typical agency theory arguments have always stressed the “residual claimant” status of shareholders and their risk-bearing as well as rights of allocation of corporate funds among business projects to establish their exclusive primacy in corporate accountability, over other stakeholder claims.<sup>26</sup> On the other hand, protagonists of stakeholder claims have argued that such accountability cannot be the exclusive preserve of the shareholders, given the contribution that others make towards the operations of the corporation.<sup>27</sup>

The Indian approach to stakeholders other than shareholders has been somewhat ambivalent. Corporate legislation till the 2013 Act did not explicitly charge the companies and their boards with any specific responsibility towards their stakeholders but over the years certain aspects of corporate obligations to the society and the environment had been introduced through audit certification requirements and later withdrawn.<sup>28</sup> It was SEBI’s Kumar Mangalam Birla Committee that, perhaps for the first time in Indian corporate regulatory history, formally acknowledged in 1999 stakeholder claims by describing the objective of corporate governance as “the enhancement of shareholder value, keeping in view the interests of other stakeholders.”<sup>29</sup>

The 2013 Act makes a significant departure from previous legislative regimes by specific provisions in this regard. **(Exhibit 2)** Thus, a director of a company is required to act “in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company, its employees, the shareholders, the community and

---

<sup>26</sup> Easterbrook and Fischel (1991), for example

<sup>27</sup> Blair (1995), for example

<sup>28</sup> A company’s statutory auditors were required to report to shareholders whether or not the specified issues were satisfactorily addressed by the company. The Manufacturing and Other Companies Audit Reports Order, for example, required such certifications in respect of compliance with effluents and their treatment; these requirements were however superseded in 2003 by a new set of requirements in the Companies (Audit Reports) Order which omitted several earlier requirements.

<sup>29</sup> SEBI (1999, paragraph 4.2)

for the protection of the environment.”<sup>30</sup> This is again reiterated in the Code for Independent Directors which stipulates that independent directors *shall* “safeguard the interests of all stakeholders,... (and) balance the conflicting interest of the stakeholders.”<sup>31</sup> A company with a *financial stakeholder* population of more than one thousand shareholders, debenture-holders, deposit-holders and any other security holders at any time during a financial year is now required to constitute of Stakeholders Relationship Committee chaired by a non-executive director, to address the grievances of security holders of the company.<sup>32</sup> Companies will still have to grapple with identifying their relevant stakeholders with clarity (for example, under the category ‘community’) in order to satisfactorily comply with these requirements. Following this trend, the listing agreement also now mandates that the company should recognise “the rights of stakeholders that are established by law or through mutual agreements are to be respected,” and “encourage mechanisms for employee participation.”<sup>33</sup>

## Absentee Shareholder Primacy and Protection

A major downside of the corporate format from the absentee<sup>34</sup> shareholders’ viewpoint is their vulnerability to exploitation by those in operational control, notwithstanding the presence of the board of directors with fiduciary responsibility to protect and promote investor interest. This leads to a more compounded principal-principal problem (besides the traditional principal-agent problem) where some shareholders also don the mantle of controlling managers. Since conventional wisdom favoured equality of voting at members’ meetings despite apparent (but inevitable) inequalities in their proximity to management control and corporate decision-

---

<sup>30</sup> Section 166 (2) - This could possibly expose company directors to potential litigation if aggrieved shareholders or some specified stakeholders were to challenge their balancing decisions. Fortunately, the comma after ‘members as a whole’ in the section could arguably be interpreted to establish shareholder primacy opposite other stakeholders. Also, given that courts normally do not ‘second-guess’ board decisions except in cases where *prima facie* circumstances warrant such intervention, directors may draw some solace that their *bona fide* decisions may not be called to question!

<sup>31</sup> Schedule IV, II (5) and (6)

<sup>32</sup> Section 178 (5) and (6)

<sup>33</sup> Clause 49, I-B-1(a) of LA

<sup>34</sup> “Absentee shareholders” denotes all those not in operational control of the corporation, explicitly reflecting their absence from day to day executive management of the company. The usual ‘minority’ label is often misleading since in many cases the absentee group may actually be the majority

making, such shareholders in control could get their way at members' meetings on matters where they may even be beneficiaries. This is further facilitated by the fact that attendance at members' meetings is usually very limited: individual or small investors may have neither the expertise nor the inclination to get involved (further exacerbated by geographical distances between their location and the meeting venue); institutional investors are generally constrained by costs of such monitoring and participation, or other pressures that interfere with their decision-making on such matters. In either case, the result is a marked indifference to actively participate in major decisions at members' meetings, a "rational reticence" that translates into a willingness to respond to governance proposals but not to proactively propose them.<sup>35</sup>

Clearly, such possibilities also weighed on board members with reservations on some of the contentious management proposals that led them to refrain from acting on their concerns since their efforts were inevitably doomed to be infructuous when such matters were put to vote at members' meetings. Such an approach on the part of directors, although theoretically untenable, cannot be wished away in practice and needed to be addressed through regulation, an objective the 2013 Initiatives have largely met. **(Exhibit 2)**

### ***Restraints on Interested Shareholders' Voting Rights***

The most important reform from an investor protection perspective is the salutary provision restraining *interested shareholders* from voting on resolutions at members' meetings, in which they were interested parties; most related party transactions would fall under this category. First included as a far-ahead-of-its-time recommendation in a 1999 government committee report,<sup>36</sup> this proposal belatedly received laudatory mention (as a "good corporate governance

---

<sup>35</sup> Gilson and Gordon (2013)

<sup>36</sup> Recommendation 35 of the *Report of the Committee on Corporate Excellence through Governance* (1999), Government of India, Department of Company Affairs, New Delhi (of which the author was privileged to be the drafting member), proposed the concept of *interested shareholders* not being permitted to vote on resolutions at members' meetings where they were interested or related parties.

practice”) in the Irani Committee report<sup>37</sup> which however stopped short of recommending legislation on the issue. It was to be almost a decade and a half before this incredibly important and eminently equitable proposal for fair governance could find its way into the statute book.<sup>38</sup>

Section 188 (1) of the Act dealing with related party transactions now stipulates:

- No contract or arrangement shall be entered into except with the prior approval of the company by a special resolution.
- No member of the company shall vote on such special resolution, to approve any contract or arrangement which may be entered into by the company, if such member is a related party.
- These restrictions do not apply to transactions in the ordinary course of business concluded at an “arm’s length” basis (defined as transactions between two related parties conducted as if they were unrelated, so that there is no conflict of interest).

The implications of these provisions are that in case of related party transactions (which are potentially a major source of tunnelling by promoters and executive management), those who stand to benefit would have no say in the voting outcome on such resolutions at members’ meetings, and further, a super majority (three-fourths) of the other shareholders would have to vote in favour of such resolutions to have them carried. These are indeed tough conditions, and hopefully, will act as effective filters to allow only such proposals as are in the larger interests of the company and all its shareholders to go through to fruition. The concomitant imperative for such measures to succeed in their objective is for all the other shareholders “negatively impacted” (to borrow a phrase from OECD) to actively participate in the evaluation and voting on such resolutions; institutional shareholders have a key role to perform in this regime, and if they do not measure up to the requirements, they will have only themselves to blame. Proxy

---

<sup>37</sup> Chapter IV - Paragraph 35 the Report commented: “[T]his was an aspect of good Corporate Governance which may be adopted by companies on voluntary basis by making a provision in the Article of Association of the company. In view of the issues related with enforcing compliance of such requirements, there need not be any specific legal provision for the purpose.”

<sup>38</sup> US courts, especially in Delaware have repeatedly extolled the concept of “majority of minority” approvals where controlling shareholders are involved, for example, in “freeze out” transactions such as mergers of controlled subsidiaries with parents or other group siblings. Illustratively, *In Re MFW Shareholders Litigation* (CA.No. 6566\_CS), decided on May 29, 2013 by the Delaware Court of Chancery (Chancellor Strine presiding), is a recent case in point

advisory services, a rapidly emerging segment in the Indian capital market scene, have also a critical part to play in fairly and impartially counselling and guiding investors on such matters.

The category of companies and the threshold materiality levels of such transactions attracting these restraining provisions prescribed by the government cover all listed corporations and other large unlisted public companies.<sup>39</sup> The qualifying thresholds hopefully are such that they would not be too low to inflict disproportionate compliance costs on companies nor too high to allow unduly unfair enrichment of a few at the cost of the many.

Not unexpectedly, such far reaching reforms have had their detractors, some of whom have predicted a “hung scenario” with managements being paralysed and dis-empowered from performing their legitimate executive functions.<sup>40</sup> What is overlooked in such protestations is the imperative need to pre-empt potential corporate incursions and expropriations so that investor protection could be enhanced. Genuine related party transactions in the overall interests of the company are largely unlikely to be blocked by such minority shareholders, especially considering the migration trends in the country towards institutional shareholding away from too widely dispersed individual shareholdings.<sup>41</sup> It should be possible for companies to carry conviction to such institutional block-holders given their smaller numbers and also their business and commercial expertise.

### ***Containing Other Private Benefits of Control***

Literature and empirical experience are replete with a breath-taking range of measures and devices that people adopt to benefit themselves from their vantage positions of control, fully justifying the “invisible hand” prognosis offered by Adam Smith some two-and-a-half centuries

---

<sup>39</sup> Rule 15 (3) of Companies (Meetings of the Board and its Powers) Rules, 2014 - Prescribed application thresholds are: paid-up capital of Rs 10 crore or more; or, where transaction(s) value in case of sale or purchase of goods or services exceed 25% of the company's turnover; or, in case of sale, purchase or lease of property, exceed 10% of its net worth; in case of remuneration to related employee, exceeds Rs 30 lacs per annum; and so on.

<sup>40</sup> For example, Shankar (2013)

<sup>41</sup> Balasubramanian and Ramaswamy (2013) - Trends over the decade 2000-11 indicate a substantial bolstering of promoters' shareholdings among the larger companies (with relatively lower controlling shareholding) but in the second tier corporations where promoter shareholdings were already strong, the movements were towards institutional investors. In either case, the potential problems with the so-called “nuisance value” individual shareholders holding companies to ransom is likely to be considerably mitigated

ago.<sup>42</sup> While it is impossible to fully eliminate such tunnelling efforts in the corporate format of business, various measures have been adopted from time to time with some limited success. The 2013 Initiatives have added a few more regulatory preventive curbs in this direction. Thus:

- Directors and their connected parties may not acquire from or sell to the company any assets for consideration other than cash unless such purchase or sale is approved by members in general meeting.<sup>43</sup> Clearly, most of these would likely be related party transactions and hence at least three-fourths of the other shareholders would have to be convinced that their interests were not adversely impacted to any material extent before they can be persuaded to vote in support of such transactions.
- Directors and Key Managerial Personnel may not engage in forward transactions in securities of the company, its holding, subsidiary or associate companies.<sup>44</sup> Already there were provisions prohibiting market trading transactions during time windows before, during, and immediately after board meetings where price sensitive matters were to be discussed but the Act provisions go much farther and stipulate among the prohibited dealings:
  - the right to call for delivery or the right to make delivery at specified prices and within a specified time, of a specified number of relevant shares or a specified amount of relevant debentures
  - the right, at his option, to call for delivery or to make delivery on a similar basis
- Directors and Key Managerial Personnel may not enter into “insider trading,” defined as
  - An act of subscribing, buying, selling, dealing or agreeing to subscribe, buy, sell or deal in any securities by any director or key managerial personnel or any other officer of a company either as a principal or agent if such a person can reasonably be expected to have access to any non-public price sensitive information in respect of securities of a company; or
  - Any act of counselling about procuring or communicating directly or indirectly any non-public price-sensitive information to any person

---

<sup>42</sup> Smith (1776, p. 313)

<sup>43</sup> Section 192 (1)

<sup>44</sup> Section 194



- “Price-sensitive information” has been defined to mean any information which relates, directly or indirectly, to a company and which if published is likely to materially affect the price of securities of the company.
- Substantial penalties prescribed for breach of these provisions will arguably deter potential defaulters but the task of establishing insider trading evidence required for judicial conviction continue as before. The recent success stories of purposeful prosecution in the US, including in the case involving Rajat Gupta and Raj Rajratnam<sup>45</sup> are useful pointers towards the pressing need for meticulous investigation and committed independent agencies (including experienced prosecutors) as well as suitable enabling legislative sanction to aid them in their efforts.

### ***Containing the Perils of Pyramiding***

A common instrument of entrenchment and for enhancement of private benefits of control is the phenomenon of pyramiding that enables control of large economic empires with relatively limited investment and risk at the top. The Act<sup>46</sup> now limits the investment tiers to no more than two layers, thereby limiting the potential for abuse of this structural mechanism. Due provisions have been made to exempt foreign company acquisitions from these restrictions.

Extensive pyramiding comprising constituent entities with varying levels of equity holdings by the promoters exposes corporations to the ills of a range of related party transactions where cash, profits, and tangible and intangible assets can be routed away to the disadvantage of absentee shareholders in companies where promoter holdings are comparatively low. This limitation of no more than two layers of investment subsidiaries will help partially in containing the ill effects of tunnelling on absentee shareholders.

It has been argued<sup>47</sup> that these provisions are overly restrictive (even draconian!) and likely to impair the legitimate freedom of corporations to structure their business operations as they deem appropriate. Clearly, these concerns overlook the basic fact that these restrictions do not

---

<sup>45</sup> Raghavan (2013)

<sup>46</sup> Section 186 (1)

<sup>47</sup> Illustratively, Debevoise & Plimpton LLP (2013)

apply to business or operational subsidiaries or affiliates, but only to “investment companies” defined as those “whose principal business is the acquisition of shares, debentures and other securities.”<sup>48</sup> Besides, several exclusions have already been provided to cater to the specific and compliance needs of different business segments; also, these restrictions do not apply to overseas acquisitions of corporations with more than two layers of investment subsidiaries of their own. It should also be highlighted that non-investment companies in general have the flexibility to invest in other companies up to 60% of their own paid-up capital, reserves and securities premium, or up to 100% of their own free reserves and securities premium whichever is higher.<sup>49</sup> There would thus seem to be substantial flexibility and freedom available to companies even after these restrictions, to structure their investments to their best advantage, but certainly no *licence* as before to engage in unbridled pyramiding to the potential disadvantage of absentee shareholders.

## **Boards and Their Processes**

Independent and objective boards committed to the welfare of the company and equitable treatment to all its shareholders is the cornerstone of good corporate governance. The 2013 Initiatives have strengthened many existing regulatory requirements and introduce some new ones too. The overall impact is one of considerably strengthened and more enabled board ambience that should help better performance in the service of the company and all its stakeholders including shareholders. **(Exhibit 2)**

### ***On Board Chair – CEO Duality***

In the context of the different roles and requirements of the two positions of board chair (monitoring) and chief executive (execution), best practice standards stipulate their separation. Notwithstanding the strong advocacy of this separation, the US predominantly continues to combine these two roles (with an independent senior or lead director in place as a

---

<sup>48</sup> Explanation (a) to Section 186

<sup>49</sup> Section 186 (2) (c)

compromise), although a glacial movement towards separation is noticeable in recent years. Indian regulation has not so far mandated such a requirement for listed companies though many companies have found it attractive to separate if only to qualify for a lower proportion of independent directors on their boards.

The Initiatives, for the first time, prescribe such separation in future in case of all listed and other large public companies.<sup>50</sup> There is no mention however as to whether the board chair has to qualify as an independent director as well.<sup>51</sup> Rather than including this requirement as part of the sections dealing with boards, directors, committees, and meetings, this separation provision is included as part of the sections dealing with Key Managerial Personnel.

There are exceptions provided for as well: this mandate will not apply if the company's Articles provide otherwise; it will not apply if the company operates several lines of business, each with its own chief executive. This latter exemption is presumably based on the distancing theory: as the respective CEOs of the businesses will be in charge of execution, the managing director will be distanced from operational responsibilities and assume an intermediary monitoring role which may not be wholly incompatible with the oversight role of the board chair. Clearly, this view is debatable: what indeed then is the role of such a managing director if he or she is not personally accountable to the board for the company's (as opposed to each constituent business unit's) performance? If the underlying logic of role separation is accepted (as it seems to have been) the exceptions do not seem defensible.

It is noteworthy that these exceptions appear to be a later introduction in the process of scrutiny and revision. The Companies Bill 2008, the Act's original predecessor, did not have these exceptions (Section/Clause 174) probably because the Irani Committee report, on which the bill was largely based, did not suggest any such exceptions; interestingly, the Voluntary Guidelines on Corporate Governance issued by the Ministry of Corporate Affairs in 2009, while advocating separation did not mention any exceptions (Para A-2) and neither did the Godrej

---

<sup>50</sup> Section 203 (1) and Rule 8 of Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 – the threshold prescribed is Rs 100 mn or more of paid-up capital

<sup>51</sup> The LA (II-A-2), however, takes cognisance of this aspect and postulates a separated board chair who is a promoter or his relative or relative of a person occupying a management position at the board level or one level below, will not qualify the board to have a lower proportion of independent directors

Report of September 2012. The Parliamentary Standing Committee on Finance that did the detailed scrutiny of that Bill (by that time, renamed as Companies Bill 2009) did not seek these exceptions; nor did the bill of 2011 which was reported upon by the Standing Committee on Finance (Para 178, p. 247-249) have any such recommendation. The insertion seems to have been done when finalising the revised version of the bill in 2012 which eventually became the Act.<sup>52</sup>

Evolution of these exceptions from the concept to the consummation stage of the legislative process is indicative of the multiple influences that shape the final product, often resulting in dilution of the original intent.

### ***On Board Composition and Objectivity***

- Every listed company (and any other notified class of companies) should have at least three directors qualifying as independent in terms of prescribed criteria.
- For the first time, the Act enumerates the qualifying criteria both in affirmative and negative terms. Thus, the person should, in the board's opinion, be one of integrity and possess relevant expertise and experience or should possess such other prescribed qualifications (in other words, should be a "fit and proper" person).
- Among the negative disqualifying criteria are the following:
  - Should not be (or have been) a promoter of the company or its holding, subsidiary or associate company, or related to promoters or directors of the company, its holding, subsidiary or associate companies; nor should he have (or have had) any pecuniary relationship with the company, its holding or subsidiary or associate companies or their promoters or directors during the current or immediately preceding two financial years

---

<sup>52</sup> The concept of a combined board chair and CEO has had long-time acceptance in the Indian corporate world, not unlike for example in the US. This has been virtually universally adopted by the government in respect of state owned enterprises; in the private sector, promoter dominance and the desire for unitary centre of authority have led to the adoption of this practice, although somewhat moderated by the lure of permitted lower proportion of independent directors on boards with separate chair and CEO. It is likely that these exceptions were introduced to allow the *status quo* to continue where so desired, even while explicitly endorsing the separation concept

- None of his relatives should have (or have had) pecuniary relationships or transactions with the company, its holding or subsidiary or associate companies, or directors, amounting to more than 2% or more of its gross turnover or total income or fifty lakhs rupees or such higher amount as may be prescribed, whichever is lower, during the current or immediately preceding two years
- Neither he nor any of his relatives
  - should be holding (or have held in any of the three immediately preceding financial years) a position of key managerial personnel, or an employee in the company, its holding, subsidiary or associate company
  - should have been an employee, or proprietor or partner in the three immediately preceding financial years, in a firm of auditors, company secretaries in practice, or cost auditors of the company or its holding, subsidiary or associate company; or any legal or consulting firm that has or has had any transaction with the company, its holding, subsidiary or associate company at a remuneration of 10% or more of such firm's gross turnover
- Should not, together with his relatives, hold 2% or more of the of the total voting power of the company
- Should not have been the CEO or director of any not-for-profit entity that receives 25% or more of its receipts from the company, any of its promoters,, directors, its holding, subsidiary or associate company or that holds 2% or more of the total voting power of the company

These extended criteria are an improvement over the extant requirements, both legislative and regulatory, and will hopefully enhance the objectivity potential of the boards.

Clause 49 of the LA takes these requirements a step further: where the positions of board chair are not separated, and where even when separated the incumbent's non-alignment with the

interests of the promoters and their associates is not established, the board is required to have one half of its members qualifying as independent.<sup>53</sup>

### ***On Making Board Independence Count***

Populating the board with a good proportion of independent directors, while certainly helpful in maintaining an appropriate balance and diversity, will by itself not be fully effective if their voice did not count for much in board discussions and decision-making processes. While we return to this topic in the next section, it is satisfying to note that the presence of at least one independent director is now necessary under the Initiatives for any resolution to be deemed validly approved at a board meeting called at *short notice* of less than seven days;<sup>54</sup> if none of the independent directors are present at such meetings, the resolutions will need to be circulated to all directors and will be deemed approved only if ratified by at least one independent director.<sup>55</sup>

A major concern associated with the frustration of the institution of independent directors has been that unscrupulous managements and promoters could get important decisions approved by convening board meetings without reasonable notice and consequently with independent directors not being able to attend. This Initiative will likely minimise the potential for this abuse to some extent.

### ***On Improving Independent Director Effectiveness***

---

<sup>53</sup> Cl. II-A-2 of LA

<sup>54</sup> There is a view that conceptually this requirement could undermine the fiduciary ability of other directors and hence unsustainable. Also, having set the presence of at least one independent director as a requirement, any meeting held in breach of this condition will be void *ab initio* and hence the question of subsequent ratification by circulation with at least one independent director approving, does not arise. These are issues which likely will be resolved in future litigation but it is important to recognize that the fundamental distinction between the role and responsibilities of independent and other directors is sanctioned by law and the impugned requirement is just an extension arising therefrom.

<sup>55</sup> Section 173 (3)

Considering that external independent directors of large corporations are in most cases people in full time occupation as CEOs or senior directors or in professional practice with heavy demands on their time, concern has often been expressed that such directors may not always be able to devote the time and effort required to do justice to their independent directorships on boards. Arthur Levitt, former SEC Chairman once estimated that some 22 working days were required to do justice to an independent directorship of a large US listed corporation. No wonder the American average of board positions hovers between two and three. But there will always be a limited few who are in much greater demand. In India, in 2010 for example, highly boarded directors (defined as sitting on five or more NSE 100 company boards) were 71 (6%) of the total 1104 director positions and controlled 66% of market capitalisation of all NSE listed companies.<sup>56</sup>

Although the Initiatives have set a generous upper limit of twenty companies and of which no more than ten may be public companies (including private companies which are holding or subsidiary companies of public companies) on whose board a director may sit,<sup>57</sup> it is arguably an improvement over the extant situation of virtually unlimited number of directorships overall including exempt directorships as alternates, and in private limited companies that are not holding or subsidiary companies of public companies, unlimited companies, and not-for-profit companies.<sup>58</sup> It is noteworthy that the LA requirements in this regard are more rigorous: the maximum number of listed company directorships has been pared down to seven, and in case of serving whole time directors in a listed company, this has been further scaled down to three others.<sup>59</sup> The limits set by the Act, it must be mentioned, still do not cover directorships or equivalents in other entities like Trusts, Cooperative Societies, Partnerships and other organisational formats where a person may choose to get involved. Clearly there are limits to which legislative or regulatory provisions can (or even should) mandate; it should be up to the company and the individual concerned to evaluate whether the required time and attention

---

<sup>56</sup> Balasubramanian, et al (2010, p. 41)

<sup>57</sup> Section 165 (1) of the Act

<sup>58</sup> Section 278 (1) of the Companies Act, 1956

<sup>59</sup> Cl. 49-II-B-2 of LA

would be possible in the circumstances and take an informed call on offering or accepting an additional directorship.

### ***On Enhancing Board Independence and Objectivity***

Ideally, board independence cumulatively should be more than the sum of its constituent parts, building on the synergies of individual members' independence and objectivity. Group interaction dynamics and mutual complementarities generally help in achieving this result which defies arithmetical logic! Several components in the Initiatives potentially offer help in achieving this very desirable objective. For example:

- The Act requires listed companies to have at least a third of their board members qualifying as independent.<sup>60</sup> Inclusion of this requirement in the statute enables wider applicability to larger unlisted companies as well.<sup>61</sup> In case of listed companies, the regulatory requirements are even more rigorous and require a minimum of one half of the board to qualify as independent:
  - where the board chair and CEO positions are combined in one individual; and,
  - even where they are separated, if the non-executive chair happens to be the promoter or his/her relative,<sup>62</sup> or a person related to another person occupying management positions at the board level or one level below.<sup>63</sup>
- The provision to have at least one woman director on board is a welcome initiative in the interests of board diversity, which should have been addressed by companies even without legislation because of not only its equitable claims but more importantly since such diversity enriches board capacity and leads potentially to better decisions.<sup>64</sup>

---

<sup>60</sup> Section 149 (4)

<sup>61</sup> Rule 4 of Companies (Appointment and Qualification of Directors) Rules, 2014 requires public companies with a paid-up capital of Rs 100 mn or more, or a turnover of 1,000 mn or more, or an outstanding loans, debentures or deposits of Rs 500 mn or more, to have at least two independent directors on their boards

<sup>62</sup> A "Relative" is defined as follows in Cl. 49-II-A-2 of LA 2014: (i) If the promoter is a listed entity, its directors other than the independent directors, its employees or its nominees; (ii) If the promoter is an unlisted entity, its directors, its employees or its nominees.

<sup>63</sup> Cl 49-II-A-2 of LA, 2014

<sup>64</sup> Balasubramanian (2013) Having said that, globally actual legislation and even a perceived threat of stringent mandates do seem to be more effective in driving such initiatives: experience in the Scandinavian and other



- The Act visualises a term-based appointment of independent directors for a period of five years, renewable (by special resolution) for a similar second term, and not subject to retirement by rotation.<sup>65</sup> This certainty of a reasonably long period in office should provide a measure of stability and continuity to this component of the board which can possibly pursue its agenda more consistently and effectively. Listed companies face stricter conditions: Independent directors who have already served for five years or more (as of October 2014) may now serve for only one more term of up to five years after the expiry of the current term.<sup>66</sup> Although this is a transitional measure, the regulator’s urgency in getting higher governance standards in place at the earliest is clearly evident.
- An innovative concept has been introduced in the Act to ensure the “independence” of persons who wish to be re-appointed as such after serving two five year terms. They can be so appointed but only after a “cool-off” period of three years and, this is important, during the three year break, the independent director “shall not be appointed in or be associated with the company in any other capacity, either directly or indirectly.”<sup>67</sup> One can only speculate as to why the applicability of this ban was limited to only the “company” and not to others in the cluster such as “its holding, subsidiary or associate company, or promoters” and so on as has been specified in so many other sections. If erosion of independence is considered to be a function of proximity and familiarity, as appears to be the case in drafting other sections on independence, it would have been consistent if the same phraseology had been used here as well. Perhaps, this would be covered under the “directly or indirectly” *caveat*; maybe, the person would be disqualified anyway under the independence criteria I Section 149 (6) (c), (which holds only for two years and not three).
- The Act settles the vexed issue of the independence status of nominee directors on company boards appointed by financial institutions, government, and such other bodies.

---

European countries and the UK where presence of women on boards is already, or getting to be, much larger support such a hypothesis. See, Davies (2011), EC (2013)

<sup>65</sup> Section 149 (10) and (11)

<sup>66</sup> CI 49-II-B-3.a of LA 2014

<sup>67</sup> Section 149 (11)

They will not be deemed independent. With this “grey” element of independence now firmly out of the way, the other independent directors could enhance their effectiveness without any inhibition that may have been occasioned by the presence of their nominee colleagues and their influence on board issues.

- Executive compensation is an issue that corporate boards around the world are grappling with and the Act appropriately mandates a Nomination and Remuneration Committee (NRC) in all listed companies and other prescribed companies. By requiring at least one half of the NRC membership to be independent directors, the board is now equipped to play a more active and objective role in determination of CEO and other executive directors’ pay and perquisites. Unlike before, boards and in particular their independent directors are in a position to influence these pay packages in the best interests of their companies, without being hamstrung by the debilitating realisation that the promoters will be able to get their way in any case at the members’ meeting by virtue of their superior voting strength. With the promoter-CEOs and directors as interested parties restrained from voting on such proposals at shareholders’ meetings, it is up to the independent directors to decide on such pay proposals as they feel appropriate and recommend to the other shareholders for their super-majority approval. If conscientiously applied in practice, boards would seem to have been unshackled from any real or imaginary inhibitions to their effectiveness in this matter and provided with an opportunity to display their objective assessment and act in the best interests of the company.
- Nomination and Remuneration Committees of listed and other large public companies<sup>68</sup> are required to evolve and disclose their remuneration policies in respect of directors, key management personnel and other employees.<sup>69</sup> Listed companies are required to disclose comprehensive details of remuneration including the break-up between fixed and variable pay, stock options, pension etc. Criteria of compensation to non-executive

---

<sup>68</sup> Rule 6 of Companies (Meetings of Board and its Powers) Rules, 2014 – companies with a paid-up capital of Rs 100 mn, or turnover of Rs 1,000 mn, or aggregate outstanding borrowings, loans, debentures and deposits of Rs 500 mn are covered for this purpose

<sup>69</sup> Section 178 (3) and (4)

directors are also required to be published in the Annual Report of the companies.<sup>70</sup> How such statutory and regulatory disclosures measure up to comparable requirements in developed markets like the US can be meaningfully assessed possibly after the first set of such reports by companies become available in mid-to-late 2015.

- The company and independent directors are required to “abide by the provisions specified in Schedule IV” of the Act,<sup>71</sup> which provides a detailed Code for independent directors. This incorporates fundamental legal, ethical and procedural principles and best practices that will be of help to directors in their role as trustees and stewards for the company and its shareholders. Many companies provide their own customised Induction Kit to their newly appointed directors; it will be a good refresher to the more experienced directors as well if they are also provided updated versions, preferably with changes highlighted so that everyone on the board is up to speed on what is expected of them both by statute and regulation, and the company and its values.
- On the flip side of all these improvements to promote the importance and contribution of independent directors, some would argue the Act has overreached itself in making the institution of independent directors very difficult for the directors to do justice to. By definition, independent directors can only be part time contributors, counsellors and controllers. By and large, they are dependent upon executive management for most of their information inputs. While their trusteeship obligations to the company and its shareholders have long been recognised and established in terms of the broad duties of care and loyalty, their interpretation in many jurisdictions have always been principle-based and not bogged down by any set of inflexible rules. Some of the provisions of the Act tend to tilt the balance towards the latter structured format of do’s and don’ts which may hinder rather than help independent directors efficient functioning.

Together with some of the provisions already in place and continued in the Act, the doors to more effective board performance appear to have been thrown open to a large extent. It is up

---

<sup>70</sup> CI 49-VIII-C of the LA, 2014

<sup>71</sup> Section 149 (8)

to the boards and their directors to capitalise on this long-awaited opportunity and take their companies' governance to higher standards. And equally, it would be in the long term interest of the promoters and managements to buy into these improvements and enhance the reputational and hence the market value of their companies.

## **Other Governance-Related Issues**

The Act has also introduced and strengthened a number of other governance-related requirements; some of these themes are briefly discussed here.

### ***On Financials, Disclosure and Reporting***

- There has been a movement to harmonise Indian accounting Standards with the global Financial Reporting Standards (FRS) for some years now. The Act takes this forward. Schedule III of the Act sets out general instructions for preparation of balance sheet and statement of profit and loss of a company.
- Meeting a longstanding demand for overall group financials, holding companies are now mandatorily required to prepare consolidated financials incorporating financials of subsidiaries (including associates and joint ventures), following standard consolidating principles, in addition to their own stand-alone financials; they are also required to attach a separate statement setting out salient features of the financials of the such subsidiaries.<sup>72</sup> There are at least two areas of concern with regard to this otherwise welcome initiative:
  - First, this requirement applies to intermediate holding companies as well, inflicting unnecessary additional costs especially if such entities are wholly-owned or with very few outside shareholders. In fact, at the other extreme, there are jurisdictions that do not even require separate independent audited

---

<sup>72</sup> Section 129 (3)

financials of consolidated unlisted subsidiaries. There is perhaps a good case for granting exemptions from consolidation requirements to such intermediate entities, through subordinate legislation, which are fully owned and/or unlisted.

- Second, Indian Tax regime does not as yet recognise the ultimate holding company as the exclusive taxable entity for the entire group; due consideration for concomitant tax reforms to in this regard may now be opportune.
- Recognising the need to formalise acceptable processes for reopening and restating the financials of a company as a fallout of fraud or mismanagement, the Act specifically provides for both voluntary (limited to three preceding years only) and involuntary (no laid down time limitation) revisiting of earlier financials.<sup>73</sup>
- A National Financial Reporting Authority (NFRA) has been created charged with responsibilities for recommending accounting standards and overseeing their compliance by companies. This authority will now subsume the functions of the erstwhile National Advisory Committee on Accounting Standards.<sup>74</sup> The government has retained its authority to prescribe accounting standards recommended by the Institute of Chartered Accountants of India (the standard setting authority with jurisdiction over its practising members for compliance) as reviewed and endorsed by the NFRA.<sup>75</sup>
- The financials of the company (including consolidated accounts, if any) are now to be signed by the Chief Financial Officer as well. With this statutory recognition, the CFOs position is vested with both onerous responsibilities and powerful authority to ensure accounting and reporting with integrity and transparency; it would be difficult for a CFO in future to hide behind hierarchical shields such as “acting under instructions of CEO “ or “not responsible for certain key aspects of the function,” and so on. On the other hand, this provides CFOs a great opportunity to perform according to professional

---

<sup>73</sup> Sections 130 and 131

<sup>74</sup> Section 132 (1) and (2)

<sup>75</sup> Section 133

standards and their own value systems in the best interests of the company and all its shareholders.<sup>76</sup>

- Reporting requirements in the Directors' annual report to shareholders have been considerably extended by the Act. Thus, there will have to be a CSR Report, an expanded directors' responsibility statement, a policy statement on criteria of appointment and remuneration of directors, statements on risk management policies and their implementation, on board performance evaluation policy and implementation, on related party transactions, just to mention a few.<sup>77</sup>

### ***On Audits, Auditors and Oversight***

- Audit independence is an important pillar of good governance. Uninterrupted tenures tend to beget a measure of familiarity and complacency that may be injurious to the required levels of independence and objectivity (not unlike in the case of independent directors).<sup>78</sup> Individuals and firms can now be appointed by shareholders of listed companies (on the recommendation of the audit committee and the board) for a fixed term of five years and two such terms of ten years in all respectively. After the expiry of their maximum terms, individual and firms will have to observe a five-year cool-off period before they can be considered for appointment again. There are certain pre-emptive measures to eliminate circumvention of these tenure prescriptions. For example, no firm will be eligible for appointment if they have one or more common partners in the exiting firm.<sup>79</sup>
- Audit independence is sought to be further strengthened by requiring a super-majority special resolution to remove an auditor before expiry of the term. The Auditor will have

---

<sup>76</sup> This also leads to what can be called the principle of *flow-through fiduciary* responsibility to the company and its shareholders, which key managerial personnel like the CFO inherit indirectly from the board and the directors. A detailed discussion of the concept and its implications is of course beyond the scope of this study

<sup>77</sup> Section 134 (3)

<sup>78</sup> It is to be noted that auditor rotation is not entirely an unmixed blessing, nor is it a conclusively established solution for protection of audit independence; it has been noted that the initial years following such rotation can be vulnerable to increased risks of audit ineffectiveness and even failure

<sup>79</sup> Section 139

an opportunity to be heard before he can be removed.<sup>80</sup> An auditor resigning before his term is required to file with the Registrar a statement explaining the reasons for his resignation. If a retiring audit firm at the end of its first term is not to be reappointed for a second term, the retiring auditor has the right to make a representation that must be circulated to members, or filed with the Registrar.

- As well as protecting the auditor from any victimisation for doing his job, there are also some serious disincentives to pre-empt auditors failing to act professionally and independently as expected. For example, the Company law Tribunal, on its own or on the representation of any concerned person inquire in to and direct the company to change the auditor if it is satisfied that the auditor had acted in a fraudulent manner or abetted and colluded with the directors or the management of the company; in that case, the auditor will be banned from acting as an auditor of any company for a period of five years. The liability for such misdemeanours will impact both the partner concerned and his firm.<sup>81</sup>
- Audit independence criteria, disqualifying a person, have also been tightened. For example:<sup>82</sup>
  - A business relationship with the company, or its subsidiary, or its holding or associate company, or subsidiary of the holding company, or an associate company
  - A relative is a director or employed as key management personnel
  - A conviction for an offence within the ten years preceding
  - A subsidiary or associate company or any other form of entity is engaged in prohibited consultancy or specialised services specified in Section 144 of the Act
- The prohibited services set out<sup>83</sup> include services such as accounting and book keeping, internal audit, investment banking, internal audit, actuarial, investment advisory, management and outsourced financial services. The important point to note is that

---

<sup>80</sup> Section 140

<sup>81</sup> Section 140 (5); the influence of the hard-learned experience of Satyam Computers is unmistakable in these provisions

<sup>82</sup> Section 141 (3)

<sup>83</sup> Section 144

provision of such prohibited services even by specified associates of the auditor or audit firm will disqualify them for appointment as auditor of a company. These associates are:

- In case of an individual auditor, his relatives or other person connected or associated with such individual or through any other entity, whatsoever, in which such individual has significant influence or control, or whose name or trade mark or brand is used by the individual
- In case of a firm, the same connections as above, of the firm or any of its partners or through its parent, subsidiary or associate entity, or through any other entity, whatsoever, in which the firm or any partner has significant influence or control, or whose name or trade mark is used by the firm or any of its partners
- The underlying objective behind all these complex provisions is simply that the “independent auditor” should not only be actually free from any economic or other influence that may militate against his ability to truly and fairly discharge his reputational obligations to the shareholders who appoint him but also be seen to be so. As in the case of independent directors, economic dependence on the audited company or group is presumed to be a potential factor eroding independence, whether or not such will be the result in every case. Since audit by itself is the least glamorous and remunerative part of an accountant’s practice, over time it has been used more as an entry point to more lucrative services such accountants have the competencies to offer; often, audit revenue is reportedly a minor proportion of the revenues generated by other services. Any impairment of such revenues from a company or a group is thus, in theory, vulnerable to independence erosion, which the Act provisions seek to prevent.
- On auditing practices and competencies, the profession has so far been guided by auditing standards issued by the Institute of Chartered Accountants of India and other international standard setting agencies. The Act now has assumed the authority to set these standards (generated by the professional body and reviewed and recommended by the NFRA) so that they are clothed with legislative sanctity to enable the auditor to



meaningfully exercise his right of access to documents and information from the company.<sup>84</sup>

- NFRA has been vested with the authority to inquire into, and punish if proven, any alleged professional or other misconduct of a chartered accountant or a firm of such chartered accountants.<sup>85</sup> This is a salutary and welcome provision since the extant system of disciplinary jurisdiction over its members being vested in the CA Institute is inherently vulnerable to conflicts of interest, as the Institute was (and is) the authority to conduct qualifying examinations, provide coaching and tuitions to the prospective candidates, certify them as chartered accountants, and also exercise disciplinary jurisdiction over them in case of misconduct. NFRA and its operating bodies by their constitution ought to be independent and broad based (and not limited only to fellow accountants) and hopefully should be able to take unbiased decisions on matters of professional discipline and conduct.<sup>86</sup> In some respects, the concept follows the Public Company Accounting Oversight Board (PCAOB) established in the US as a private not-for-profit corporation under the Sarbanes-Oxley Act of 2002 and the Professional Oversight Board (POB) in the UK created by the Financial Reporting Council in 2006. There are of course significant differences between NFRA (jurisdiction not limited to listed companies) and PCAOB (jurisdiction only over publicly traded company accounts and auditors) or POB (with disciplinary action remaining with professional institutes exclusively). It is noteworthy that in the PCAOB, the five-member board is mandated not to have more than two certified public accountants (with no affiliations or practice for at least two years) and if the board chair is a CPA, he should have been away from active practice for at least five years. A clearer picture of NFRA's operating functions and procedural regimes will emerge once related rules and regulations are formulated, but this initiative is certainly to be commended as a step in the right direction.

### ***On Prevention of Oppression and Mismanagement***

---

<sup>84</sup> Section 143 (1)

<sup>85</sup> Section 132 (4)

<sup>86</sup> Regrettably, the proposed composition of NFRA's disciplinary committee falls short of this expectation since it includes representation for the regulators (SEBI and RBI) and administrators (Serious Frauds Office) which may lead to the prosecutors also acting as the judges!

Extant company legislation already had provisions to protect absentee shareholders against oppression and mismanagement by incumbent management, whether promoter controlled or otherwise. Broadly these protection measures have been retained in the 2013 Initiatives.<sup>87</sup> In addition, for the first time in the country, provision has also been made in the Act for “class” action by affected shareholders against the company, its directors and even against external constituents like statutory auditors or other experts and consultants in respect of any grievances relating to actions or inactions prejudicial to the aggrieved shareholders’ interests. Two key implications of the Act provisions need highlighting:<sup>88</sup>

- This remedy available not only to the shareholders but also to ‘depositors’ of funds in the company. Depositors have not been specifically defined but ‘deposit’ has been defined as “receipt of money by way of deposit or loan or in any other form by a company”, subject to any exceptions that may be notified.
- The remedy is not limited to claims against the company, its board and management but is also extended to cover auditors, experts, consultants and any other persons for any incorrect or misleading statement made to the company or for any fraudulent, unlawful or wrongful act or conduct on their part. How this provision will work out in practice will be watched with great interest, especially given its wide import and application.

The minimum number of shareholders or depositors who can prefer such class action suits is one hundred or a percentage of the class as prescribed from time to time.

While these provisions are welcome as a countervailing measure against possible managerial abuse inimical to the shareholders (and depositors) and also as a reiteration of shareholder primacy over management in such abusive circumstances, one will have to wait and watch to see how these pan out in practice. Whether these will overly constrain managerial enterprise and execution of policies of value to the company and its members in general or whether these will lead to the desired objective of minimising managerial misadventures and malpractices to

---

<sup>87</sup> Sections 241 to 244

<sup>88</sup> Section 245

the detriment of the company and its shareholders, the impact of this well-intended experiment will be watched keenly by all concerned.

## **Unlisted Companies Governance**

There is generally an incorrect perception that 'unlisted' or 'closely held' companies are small, mostly family-run and relatively insignificant part of the corporate sector when it comes to policymaking and regulation relating to their governance. Undoubtedly, this group includes a vast proportion of such small and medium size entities but it is also home to several very substantial corporations which qualify as unlisted only by virtue of their ownership structures notwithstanding their revenues, profits, employee population, customer and vendor base, and sourcing of funds from banks and financial institutions. Illustratively, a Reserve Bank of India study of finances of select private limited companies (covering 6.8% of the paid up capital of all private limited companies at work) as of March 2012 indicated that the ratio of total borrowings (including both long and short term funds) to equity was 74.1 to 25.9;<sup>89</sup> in other words, three fourths of the finances of these companies were borrowed from banks and financial institutions, and as such there was nothing strictly private about these companies except their ownership that was closely held. Many of these private limited companies would be joint ventures, wholly owned subsidiaries, venture-capital or other investor assisted units, and so on.<sup>90</sup> Several companies in these groups may well be aspiring for listed status in the near future; ironically, the group would also include companies that preferred to delist from stock exchanges for whatever reason.

A major thrust of the Act has been to extend several good governance practices to the unlisted segment of corporate business. As of December 2012, there were 852,957 companies at work comprising 806,666 private limited companies and 66,291 public limited companies; of these,

---

<sup>89</sup> RBI (2013, p. 141)

<sup>90</sup> Vermeulen (2006)

about 6500 (10%) public companies were listed on the two major Indian stock exchanges.<sup>91</sup> Given their predominant contribution to a nation's economy and employment potential, not to mention their extensive use of borrowed funds to sustain their operation, adoption of good corporate governance practices voluntarily or by legislation will likely help to improve their performance and reputational perceptions. Recognising these imperatives, guidelines have already been issued for such companies in Europe and the UK.<sup>92</sup> Due allowance has also been made to minimise the costs of governance by segregating smaller from the relatively larger unlisted companies in these guidelines.

In India, while SEBI over the last decade and more has gradually strengthened regulatory requirements in respect of listed companies, the vast unlisted segment has received virtually no major policy interventions in this regard. The 2013 Act has taken the first steps to bridge this enormous vacuum by extending several good governance practices to the unlisted companies segment.

The Act and the rules framed thereunder reckon several criteria thresholds for extending application of such governance practices to unlisted companies. Primarily, these are based on paid-up capital and net worth, sales revenue, profits after tax, number of shareholders, deposit holders and debt security holders, and the extent of bank and other borrowings. Threshold levels of course will have to be such that they ensure additional costs of governance are commensurate with desired levels of benefits to the companies themselves and their stakeholders. Exhibit 4 sets out some selected corporate governance requirements extended to unlisted public companies. There are daunting problems ahead: appropriate capacity building exercises have to be undertaken, both in getting these companies' buy-in to the new measures (based on their value-add to them rather than on threat of punishment for non-compliance) and in enlarging the pool of independent directors, and other key management personnel to take up the relevant responsibilities.

---

<sup>91</sup> MCA (2013, pp. 21-22); SEBI (2013, p. 10) : National Stock Exchange (1,666) and Bombay Stock Exchange (5211), with several common cross listings

<sup>92</sup> ECoDA (2010), IoD (2010)

How this interesting experiment works out in practice and to what extent it helps in upgrading the overall standards of corporate governance in the country will be keenly watched by investors, regulators, and company managements not only in India but elsewhere in the developing world as well.

### III

## The Unfinished Agenda

Important and pioneering as many of these Initiatives are, there are still miles to go before one can claim, if ever at all, to have scaled commanding heights in governance. Mary Schapiro, the former SEC Chair, very aptly portrayed the scene: "... when you've struggled up the side of an impressive ridge and paused to enjoy your achievement...only to look around and discover ... another hill ahead, another ascent to undertake."<sup>93</sup> Without detracting from the considerable merits of the Initiatives already launched, the following further thoughts seem worthy of pursuit if Indian corporate governance standards are to move up the scale to the next level of excellence.

### On Empowering Board Independence

From an Agency theory perspective, an independent, objective, non-aligned and trustworthy board of directors is an essential building block for the protection of shareholders' interests. Over the last decade and more, regulatory measures have been gradually strengthened to bring about a measure of board independence in case of listed corporations. The Act has also for the first time in Indian corporate legislative history provided a definition of independence and mandated the minimum proportion of directors on company boards who should qualify as independent. But as the Right Honourable Lord Justice Stephen Sedley pointed out a decade and a half ago in a different context, that the *rule of law* is a "necessary but not a sufficient"

---

<sup>93</sup> Schapiro (2010)

condition for a decent society,<sup>94</sup> populating boards with adequate number of independent directors may be necessary but not sufficient to achieve the objective of board independence. One could ask what else needs to be done: clearly, having inducted independent directors on to the board, they should be enabled to act and their voice should count. Two measures might be helpful in this regard:<sup>95</sup>

- The quorum requirements for duly constituting a board or committee meeting should be modified to require that at least a minimum number of independent directors should be present bearing the same proportion of independent directors to the total number of board members. Thus if independent directors constitute one half of the board, then one half of the quorum requirement should comprise of such independent directors (rounded up to the next higher integer) or one independent director, whichever is higher, to form a due quorum. This principle of has already been recognised in the Act which lays down at least one independent director must be present at meetings summoned at short notice;<sup>96</sup> what is being suggested is that it should be extended to all meetings and in due proportion.
- In terms of approvals at board and committee meetings, the law should be modified to require affirmative votes in favour by at least a majority of independent directors present or participating through video-conferencing before a resolution can be deemed duly approved.

Measures such as these would enable the institution of independent directors to perform its assigned duties and meet expectations. If even after such enabling environment some independent directors do not wish to, or are unable to discharge their duties, they will have only themselves to blame for such failures.

## On Strengthening Audit Independence

---

<sup>94</sup> Sedley (1998); cited in Nariman (2013, p. 245)

<sup>95</sup> Balasubramanian (2009, pp. 563-566)

<sup>96</sup> Doubts on the conceptual sustainability of this provision have already been noted – refer to earlier foot note 54

The Act provisions are a significant improvement over extant requirements with regard to ensuring perceived objectivity and independence of audit and the auditors of listed companies. And yet, in search of further excellence in this field, three themes that look promising are explored here.

- Auditor independence, to the extent one grants that as an achievable possibility,<sup>97</sup> is vulnerable to erosion for a number of reasons, among them economic dependence, familiarity, complacency and gratitude. The Act sets out and prohibits many relevant situations that may lead to such erosion of auditor independence. But all these are company-centric disqualifications. They would work well in case of stand-alone companies. But as is well known, dominant ownership by groups (of domestic, multinational or government parentage) is a prominent feature of the Indian corporate sector. It is not unusual for audit firms to be engaged for several companies in the group. While independence-eroding engagements in case of individual and group companies are largely addressed by the Act,<sup>98</sup> appointments as statutory auditors of group companies and their fall-out on audit independence are yet to be fully addressed. If a ten-year ceiling is considered optimal for tenure as auditors without impairing their independence, would it not be a logical extension to compute the ten-year tenure not just for a company but for a group as a whole? In other words, the tenure clock would run from the year where the firm is appointed as statutory auditors for any company in the group; during that period, the same firm can be appointed as auditors for any other company in the group but the end-year will coincide with the tenth year of the first appointment for a group company. After this, a five-year cool off period will be observed before they can return as statutory auditors for companies in the group.

---

<sup>97</sup> Bazerman, et al (1997) have argued, relying upon on earlier research by Messick and Sentis (1979) and Lowenstein, et al (1993), using psychological experiments, that the very nature of relationships between the auditor and the audited involves a “self-serving bias” that makes it impossible for the auditor to be independent. Given regulatory and legislative guidance and mandates over the years to facilitate auditor independence, it is perhaps reasonable to believe auditor independence is not wholly impossible and reasonable levels of such independence are feasible

<sup>98</sup> Section 144

- The second relates to any relationships between the auditors and the company or group during the cool-off period of five years before their return as statutory auditors for any company or group company. If the intention of the cool-off period is to achieve a measure of distancing between the parties so that independence levels are restored, it should follow that during that interregnum, the auditor should have no engagements for any kind of professional services with the company or the group. Failing this, the cool-off period has no real significance and may as well be written off as an infructuous cosmetic measure.
- The third relates to the process of appointment of independent auditors. The board (through its audit committee) chooses the auditors and recommends their appointment for shareholders approval. The question that needs addressing is which directors at board and committee meetings, and which shareholders at members' meetings should have the right to participate and vote on the appointment proposal. It would be prudent to remember that the accounts and reports are prepared by the executive and are based on their operations and activities during the period under reporting. Does it stand to reason that the very persons, whose work and financials are to be audited for reporting to the shareholders, should have a say in the appointment of the auditors who would be judging their financials? To stretch the point, would it be a tenable proposition for a defendant or accused in a trial to be given the authority to name a judge of his choice to hear the case? Pursuing this conceptual line of thinking, one could argue that only the independent directors should participate and vote on auditor choice at the audit committee and board meetings and any shareholders in operational control or acting in concert with them need to be barred from participating or voting on resolutions relating to appointment and remuneration of auditors at the general meeting of shareholders.

There would of course be strong opposition to these proposals from both the controlling groups and the auditors themselves. The latter's resistance would largely be due to the dislocation and possible diminution in their professional practice but these fears can easily be



allayed. All that would happen if these proposals were to go through would be a rejig of companies in the portfolio of the top ten to fifteen audit firms: instead of several group companies in their fold, each of these firms would find themselves having wider dispersal of companies from different groups, which is probably a more independence-promoting solution since their dependence on fewer groups would be diluted.

Controlling shareholders (promoters) would of course be unhappy that their rights as shareholders were being denied if they were not permitted to vote on audit appointments at members' meetings. This argument is not dissimilar to that advanced against the proposal to debar their voting on resolutions where they were interested or related parties; similar reasoning in case of related party transactions that eventually saw their voting rights curtailed by the Act would justify the present proposal as well: their rights as shareholders will not be denied if they were also not in executive management of the company; if they were in such executive management, then they should be open to be audited by a firm not necessarily of their choice. Even now, statutory auditors of public sector enterprises are appointed by the Comptroller and Auditor General of India, a constitutional authority independent of the Executive, and not by the boards or the government exercising their ownership rights as shareholders of those enterprises.<sup>99</sup>

In practice, company managements with good governance will likely have no problem with these proposals. Also, this measure would further help auditors to feel more independent of the executive which can only be a good thing as far as absentee shareholders are concerned.

## On Disclosure and Reporting

A great deal of work has already been done for improving transparent reporting and disclosure by companies. There is perhaps one area that could do with some further regulatory intervention. This is to do with continuing disclosure of material related party arrangements and shareholder agreements. Current laws require disclosure of such material contracts and so

---

<sup>99</sup> Alternatively, in case of listed state owned enterprises, independent directors on their board and the non-government shareholders may be charged with the responsibility of respectively recommending and appointing their independent auditors

on in the year they take place, or when the company goes for a public issue of its securities. The intention of such disclosure is to reduce asymmetry of information between and among shareholders *inter se*. If contracts have (as many of them do) continuing relevance to shareholders (including those who became shareholders subsequently), it would seem reasonable to ensure continuing disclosure of such arrangements in the annual reports of the companies. Illustratively, shareholder agreement provisions between joint venture partners or the promoting entrepreneurs may have a continuing relevance to the company's shareholders long after the contracts were entered into.<sup>100</sup>

## In Conclusion

The Companies Act of 2013 is indeed an immensely significant legislation in the history of corporate law in India, in many ways comparable to its fifty-seven year old predecessor Act of 1956, which at the time brought in radical changes in the way Indian corporations were to run. Undoubtedly, the Act has shortcomings yet to be addressed. Although it has taken more than a decade in the making, one could unhesitatingly state that the final product was worth the wait. It can be seen as the harbinger of good governance in the Indian corporate sector. Much will of course depend upon the speed and rigour with which its provisions are enforced over time. One thing clearly seems certain: while there may be some fine tuning amendments required in the light of experience gained in its working, there is unlikely to be any worthwhile case for looking back as far as the tidal flow towards better governance expectations from the corporate world it has unleashed. And yet, there are miles to go before the country can rest!

---

<sup>100</sup> Exit arrangements between joint venture partners (TVS Suzuki 2002, Hero Honda 2011, where the surviving domestic partner acquired the outgoing partners' equity at considerable discount to market prices), or nomination rights of co-promoters in respect of board seats and positions (Yes Bank 2013 where the surviving promoter is questioning the transmission of such rights to the successors in case of a deceased promoter), or where the controlling shareholders retain rights to enforce policy directions impacting upon a company's commercials (SAIL 2010, where the government as the controlling shareholder of a listed public sector enterprise directed the company, in public interest, to guarantee supplies to power-producing customers even at a potential loss to the company), are some random instances where such continuing disclosures could have reduced information asymmetry

-----

## **References**

[In addition to those listed in Exhibit 1]

Balasubramanian, N (2013), *Gender Equality, Inclusivity and Corporate Governance in India*, Journal of Human Values, 19-1, April, Management Centre for Human Values, Indian Institute of Management Calcutta – Sage, New Delhi

Balasubramanian, N (2013), *Review of Corporate Governance Norms – Response to SEBI’s Consultation paper on Regulatory reforms*, January

Balasubramanian, N (2009), *Addressing Some Inherent Challenges to Good Corporate Governance*, The Indian Journal of Industrial Relations: A Review of Economic & Social Development, Shri Ram Centre for Industrial Relations and Human Resources, New Delhi. Volume 44, No. 44, April;  
<http://ssrn.com/abstract=2125801>

Balasubramanian, N (2005), *Embedding CSR for Competitive Business Advantage*, Hindu Business Line, Chennai, June 13

Balasubramanian, N (2004), *Comments & Suggestions on the Concept Paper on Approach to Company Law Reforms*, Centre for Corporate Governance and Citizenship & Centre for Public Policy, Indian Institute of Management Bangalore. Round Table Discussion Backgrounder, December 4

Balasubramanian, Bala N and Anand Ramaswamy (2014), *Ownership Trends in Corporate India (2001-2011): Evidence and Implications*, NSE Working Paper WP/11/2014, National Stock Exchange of India, Mumbai. [www.nseindia.com/research/content/res\\_WorkingPaper11.pdf](http://www.nseindia.com/research/content/res_WorkingPaper11.pdf)

Barua, Samir Kumar and Jayant R Varma (1993), *The Great Indian Scam: Story of the Missing Rs 4000 Crore*, Vision Books, New Delhi

Basu, Debashis and Sucheta Dalal (2001), *The Scam: Who Won, Who Lost, Who Got Away – From Harshad Mehta to Ketan Parekh*, KenSource Information

Bazerman, Max H, Kimberley P Morgan, and George F Lowenstein (1997), *The Impossibility of Auditor Independence*, Sloan Management Review, Summer, pp. 89-94

Bowen, H R (1953), *Social Responsibilities of the Businessman*, Harper & Collins, New York

Blair, Margaret (1995), *Ownership and Control: Rethinking Corporate Governance for the Twenty-First Century*, Brooking Institution, Washington

BSE (1968), *Story of the India Stock Exchange*, The Stock Exchange, Bombay

D & P (2013), *India’s New Company Law Regime*, Debevoise and Plimpton LLP, London,  
<http://www.debevoise.com/files/Publication/064b7f61-e438-4933-9ce9-9ee7e579bb9f/Presentation/PublicationAttachment/800a8368-3f1a-4864-bdf6-afc375b5dbd5/India%27s%20New%20Company%20Law%20Regime.pdf>

Davies, L Merwyn - Lord Davies of Abersoch (2011), *Women on Boards 2011*, Government of the United Kingdom

Easterbrook, Frank H and Daniel R Fischel (1991), *The Economic Structure of Corporate Law*, Harvard University Press

EC (2013), *Regulatory Pressure gets the Ball Rolling*, Press Release of 25 January, European Commission, Davos

ECoDA (2010), *Corporate Governance Guidance and Principles in Europe*, The European Confederation of Directors' Associations, Brussels

Friedman, Milton (1979), *Monopoly and Social Responsibility in Capitalism and Freedom*, University of Chicago Press

Gilson, Ronald and Jeffrey N Gordon (2013), *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, Columbia Law Review, Vol. 113, pp. 863-927

IoD (2010), *Corporate Governance Guidance and Principles for Unlisted Companies in the UK*, The Institute of Directors, London

Lowenstein, George, Samuel Issacharoff, Colin Camerer and Linda Babcock (1993), *Self-Serving Assessments of Fairness and Pretrial Bargaining*, Journal of Legal Studies, Vol. 22, pp. 135-159

MCA (2013), *Parliament Passes the Historic Companies Bill 2012*, Press Note of Ministry of Corporate Affairs, Government of India; <http://pib.nic.in/newsite/erelease.aspx?relid=97956>

MCA (2013-a), 2012-13 Annual Report of the Ministry of Corporate Affairs, Government of 2012-13

Messick, D M and K P Sentis (1979), *Fairness and Preference*, Journal of Experimental Social Psychology, Vol. 15, Issue 4, pp. 418-434

Mitra, Meera (2007), *It's only Business: India's Corporate Social Responsiveness in a Globalized World*, Oxford University Press, New Delhi

Nariman, Fali S (2013), *The State of the Nation*, Hay House India, New Delhi

Raghavan, Anita (2013), *The Billionaire's Apprentice*, Hachette India, Gurgaon

RBI (2013), *Finances of Non-Government, Non-Financial Private Limited Companies, 2011-12*, Company Finances Division of the Department of Statistics and Information Management, Reserve Bank of India, Mumbai; RBI Bulletin, November 2013

Robé, Jean-Phillippe (2012), *Being Done with Milton Friedman*, Accounting, Economics, and Law, Vol. 2: Iss. 2, Article 3

Schapiro, Mary L (2010), *Focusing the SEC's Regulatory Agenda on Investors*, U.S. Securities and Exchange Commission, July 10

SEBI (2013), Annual Report of the Securities and Exchange Board of India, Mumbai

Sedley, Lord Justice Stephen (1999), *Freedom, Law and Justice – The Hamlyn Lectures*, Sweet & Maxwell, London

Shankar, Nivedita (2013), *New Regime of Corporate Governane: Heading towards Hung Companies*, Parts I and II, 26 and 27 November; [www.indiacorplaw.blogspot.in](http://www.indiacorplaw.blogspot.in)

Shroff, K R P (1962), *History and Current Position of the Stock Market in India*, The Stock Exchange, Bombay

Smith, Adam (1776), *The Wealth of Nations*, Kindle Edition, [www.amazon.com](http://www.amazon.com)

Vermeulen, Erik P M (2006), *The Role of the Law in Developing Efficient Corporate Governance Frameworks*, in *Corporate Governance of Non-Listed Companies in Emerging Markets* (2006), Organisation for Economic Cooperation and Development, Paris

## Exhibit 1

### Corporate Governance in India: A Chronology of Recent Developments

Year	Document
1996	<i>Corporate Governance – A Desirable Code</i> , Confederation of Indian Industry, New Delhi
1999	<i>Report on Excellence in Corporate Governance</i> (1999). Report of the Task Force constituted by the Department of Company Affairs, Ministry of Law, Justice and Company Affairs, Government of India, New Delhi; November <a href="http://dca.nic.in/corp-exc.htm">http://dca.nic.in/corp-exc.htm</a>
1999	<i>Report of the SEBI (Kumar Mangalam Birla) Committee on Corporate Governance</i> , Securities and Exchange Board of India, Mumbai; December <a href="http://web.sebi.gov.in/commreport/corpgov.html">http://web.sebi.gov.in/commreport/corpgov.html</a>
2001	<i>Report of the Advisory Group on Corporate Governance</i> (2001), Dr. R H Patil, Reserve Bank of India, Mumbai; March <a href="http://www.rbi.org.in">http://www.rbi.org.in</a>
2002	<i>Report of the Consultative (Dr A S Ganguly) Group of Directors of Banks / Financial Institutions</i> (2002), Reserve Bank of India; April; <a href="http://www.rbi.org.in">http://www.rbi.org.in</a>
2003	<i>Report of the SEBI (N R Narayana Murthy) Committee on Corporate Governance</i> , Securities and Exchange Board of India, Mumbai; February <a href="http://web.sebi.gov.in/commreport/corpgov.pdf">http://web.sebi.gov.in/commreport/corpgov.pdf</a>
2004	<i>Report of the (Naresh Chandra) Committee on Corporate Audit and Governance</i> , Department of Affairs, Government of India, New Delhi; <a href="http://dca.nic.in/naresh/index.htm">http://dca.nic.in/naresh/index.htm</a>
2004	<i>Concept Paper – Note on the Approach [to Companies Legislation]</i> , Ministry of Corporate Affairs, Government of India, New Delhi
2005	<i>Report of the (Dr Jamshed J Irani) Expert Committee on Company Law</i> , Ministry of Company Affairs, Government of India, New Delhi; <a href="http://dca.nic.in/report_expertcomt.htm">http://dca.nic.in/report_expertcomt.htm</a>
2009	<i>Corporate Governance Voluntary Guidelines</i> , Ministry of Corporate Affairs, Government of India
2009	<i>Corporate Social Responsibility Voluntary Guidelines</i> , Ministry of Corporate Affairs, Government of India, New Delhi
2009	<i>Report of the CII (Naresh Chandra) Task Force on Corporate Governance</i> , Confederation of Indian Industry New Delhi
2010	<i>Standing Committee on Finance (Twenty-First) Report on Companies Bill, 2010</i> , Lok Sabha Secretariat, Government of India, New Delhi
2012	<i>Standing Committee on Finance (Fifty Seventh) Report on The Companies Bill, 2011</i> , Lok Sabha Secretariat, Government of India, New Delhi
2013	<i>Consultative Paper on Review of Corporate Governance Norms in India</i> , Securities and Exchange Board of India, Mumbai. March 2013. <a href="http://www.sebi.gov.in">www.sebi.gov.in</a>
2013	<i>The Companies Act 2013</i> , (No.18 of 2013), The Gazette of India, Extraordinary, Part II, Section 1, No. 27, 30 August 2013, New Delhi. [Effective (Notification) date: 29 August 2013]
2014	<i>Corporate Governance in Listed Entities – Amendments to Clauses 35B and 49 of the Equity Listing Agreement</i> , SEBI Circular CIR/CFD/POLICY Cell/2/2014 dated 17 April 2014 to all Recognised Stock Exchanges, <a href="http://www.sebi.gov.in/cms/sebi_data/attachdocs/1397734478112pdf">www.sebi.gov.in/cms/sebi_data/attachdocs/1397734478112pdf</a>





## Exhibit 2

### Selected Path-breaking Governance Initiatives in 2013-14: Listed Companies

[S: Section in Act; 2013 Sch.: Schedule in 2013 Act; R: Rule in Companies Rules 2014, prefixed with Act Chapter Number; Cl.: Clause 49 in Listing Agreement 2014] [Listing Agreement Provisions supplementing Act provisions are in *italics*]

Governance Theme	Companies Act 2013	
	Reference	Provision
Corporation & Society	S 135 Sch. VII	Large companies (Rs 5000+ mn net worth or Rs 10000+ mn sales revenue, or Rs 50+ mn net profit) to spend on CSR activities 2% of average net profits over three preceding years; to form a board CSR Policy Committee of three or more directors, one of whom should be independent, and Report to shareholders
	S 166 (2) Cl. I-B-1	Directors to act in the best interests of the company, its employees, the shareholders, the community and for the protection of environment <i>Companies to recognize rights of stakeholders established by law and encourage cooperation; encourage mechanisms for employee participation; and devise effective whistle blower mechanisms</i>
	S 177 (5)	All companies with more than one thousand shareholders, debenture-holders, deposit-holders and any other security holders to constitute a Stakeholders Relationship Committee chaired by a non-executive director and comprising other members as necessary, to consider and resolve security holders' grievances
Absentee Shareholder Primacy & Protection	S 181	Prior permission of the company in general meeting required for any contribution to <i>bona fide</i> charitable and other funds if in the aggregate such contributions in any financial year exceed five per cent of average net profits for the three immediately preceding financial years
	S 186 (1)	Corporate investments to be carried out through no more than two layers of investment companies (with certain exceptions related to acquisition of foreign companies, etc)
	S 188 R 12 - 15	Related party transactions (other than in the ordinary course of business and not on 'arm's length' basis) of not less than the prescribed size need to be approved as a special resolution requiring super-majority of 75%, without the interested members voting their shares
	S 192 (1)	Directors and their connected parties not to acquire from or sell to the company any assets for consideration other than cash unless approved by members in general meeting
	S 194	Directors and Key Managerial Personnel not to engage in forward transactions in securities of the company, its holding, subsidiary or associate companies
	S 195	Prohibition of Insider Trading by Directors and Key Managerial Personnel; exemplary punishment for breach: fine up to Rs 250 mn and/or imprisonment up to five years

Governance Theme	Companies Act 2013	
	Reference	Provision
	S 149 (1) R 11 – 3 Cl. II-A-1	Companies with a paid up capital of Rs 1,000+ mn, or turnover of Rs 3,000 mn, to have at least one woman director on their board  <i>Listed companies irrespective of size to have at least one woman director on their board</i>
Boards & Processes	S 149 (4)  Cl. II-A-1 & 2	Every Listed Company to have at least one third of its board qualifying as independent directors  <i>Not less than one third of the board to be independent, if and only if, the positions of Board Chair and CEO are separated, with the non-executive Chair not being a promoter, a person related to the promoter or to a person occupying management position at the level of the board or one level below; in all other cases, not less than half the board should comprise of independent directors.</i>
	S 149 (6) S 149 (7)  Cl. II-B-1-e(v) & (f)	Criteria of independence set out; nominee directors not to qualify as independent  <i>In addition to the Act requirements, to qualify as independent, a director ought not to be a material supplier, service provider or customer or lessor or lessee of the company; and should be at least 21 years old</i>
	S 149 (8) Sch. IV	Company and independent directors to abide by the detailed Code provisions in the Schedule that cover their role, duties, appointment, resignation, performance evaluation, and so on)
	S 149 (9)	Independent directors not eligible for stock options
	S 149 (10) S 149 (11) S 149 (13)	Not more than two consecutive terms of five years each as <i>independent directors</i> ; thereafter, three years cool-off period prescribed to qualify for reappointment as independent; no association with the company in any capacity, directly or indirectly, during the cool-off period ; independent directors exempted from retirement by rotation provisions
	S 149 (12)	Limitations on liability of independent directors for acts of omission and commission
	S 161 (1) S 161 (2)	Persons failing to get elected at a members’ meeting barred from being appointed by the board as additional directors or alternate directors
	S 165 (1)  Cl. II-D-2	Persons not to be directors in more than twenty companies, of which no more than ten may be public companies  <i>Directors not to be a member of more than ten committees or chairs of more than five committees across all public companies where they are directors; for this purpose, only Audit Committees and stakeholders’ Relationship Committees are to be reckoned</i>
	S 173 (3)	In the absence of all independent directors from a meeting of the Board (convened at short notice of less than seven days), decisions taken at such a meeting must be circulated to all the directors and shall be final only on ratification by at least one independent director

	S 177 (2)	Listed companies to have audit committees of at least three directors, with a majority of them being independent and (including its chairman) financially literate
	Cl. III-A	<i>Two-thirds of the Audit Committee to be independent; all members to be financially literate and at least one member to have accounting and financial management expertise; the Chairman to be an independent director</i>
	S 178 (1)	Listed companies (and others as prescribed) to have Nomination and Remuneration Committees of three or more non-executive directors with at least one half of them being independent, and the board chairman being barred from chairing the committee
	Cl. IV-A	<i>Committee to comprise wholly of non-executive directors with half the membership and the Committee Chair being independent directors. Committee to formulate criteria for evaluation of independent directors, and also devise policy on board diversity</i>
	S 203 (1) R 13 - 8	Listed companies not to combine managing director and board chair positions unless provided otherwise by their articles or they carry on multiple businesses with separate CEOs for each such business; also, to appoint whole time key management personnel (CFO, Company Secretary, and CEO or Manager or whole time director)
	Cl. V-A	<i>At least one independent director of the holding company to be a director on material non-listed Indian subsidiaries (materiality: 20+% of net worth or income of the consolidated net worth or income)</i>
	Cl. V-B	<i>Listed holding company Audit Committee to review financial statements and investments by unlisted subsidiaries</i>
	Cl. V-F & G	<i>No holding company shall dispose of shares in material subsidiaries to less than 50%, or sell, dispose, or lease material subsidiary assets without special resolution approval by its shareholders</i>

Governance Theme	Companies Act 2013	
	Reference	Provision
Financials, Disclosure & Reporting	S 129 (1) Sch. III	Substantial enhancement of financial and operational details required to be provided with financials
	S 129 (3)	Companies with subsidiaries, joint ventures or associate companies required to produce consolidated accounts in the format applicable to them, following consolidation principles to be prescribed; and provide a statement containing the salient features of the financials of its subsidiaries
	S 130 S 131	Provisions relating to revision and restatement of accounts introduced
	S 132 (2)	National Financial Reporting Authority to advise on Accounting Policies and Standards, monitor and enforce compliance
	S 134 (3)	Significant enhancement of disclosure requirements in Directors' report to shareholders (including a CSR report, directors' responsibility statement, policy statement on criteria of appointment and remuneration of directors, and so on)
	S 139 (2) S 139 (3)	Auditors to be appointed for a term of five years (if an individual) or two such consecutive terms (if a firm) after which they (and firms with commonality of their partners) may not be appointed for the same company for a cool-off period of five years; in case of firms, shareholders may decide the frequency (if any) of rotation of audit partners within the firm in charge of the audit
	S 140 (2)	An auditor resigning before the end of the term to mandatorily file with the company and the Registrar (and the C&AG in certain cases) a statement of reasons and other relevant matters that led to the resignation
	S 140 (5)	By a special resolution, an auditor may be removed or not reappointed even when otherwise eligible; the government or the Tribunal may also direct the company to remove or not to reappoint the auditor, if convinced such action is justified; in that even the auditor or audit firm will be debarred from appointment as auditor of the company for a period of five years from the order

## **Exhibit 3**

### **Prescribed CSR Activities**

**(Extracts from Schedule VII of the Companies Act 2013)**

---

Activities which may be included by companies in their Corporate Social Responsibility Policies

1. Eradicating extreme hunger and poverty;
  2. Promotion of education;
  3. Promoting gender equality and empowering women;
  4. Reducing child mortality and improving maternal health;
  5. Combating human immunodeficiency virus, acquired immune deficiency syndrome, malaria and other diseases;
  6. Ensuring environmental sustainability;
  7. Employment enhancing vocational skills;
  8. Social business projects;
  9. Contributing to the Prime Minister's National Relief Fund or any other fund set up by the Central or State Governments for socio-economic development and relief and funds for the welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women; and
  10. Such other matters as may be prescribed.
-

## Exhibit 4

### Un-Listed Public Companies: Selected Governance Initiatives in 2013-14

[S: Section in Act; 2013 Sch.: Schedule in 2013 Act; R: Rule in various Companies Rules 2014]

Governance Theme	Companies Act 2013	
	Reference	Provision
Corporation & Society	S 135 Sch. VII	Large companies (Rs 500+ cr net worth or Rs 1000+ cr sales revenue) to spend on CSR activities 2% of average net profits over three preceding years; to form a board CSR Committee with a non-executive director chairing, and Report to shareholders
	S 166 (2)	Directors to act in the best interests of the company, its employees, the shareholders, the community and for the protection of environment
	S 177 (5)	Companies with more than one thousand shareholders, debenture-holders, deposit-holders and any other security holders to constitute a Stakeholders Relationship Committee, to consider and resolve grievances of security holders, chaired by a non-executive director and comprising other members as necessary
Absentee Shareholder Primacy & Protection	S 181	Prior permission of the company in general meeting required for any contribution to <i>bona fide</i> charitable and other funds if in the aggregate such contributions in any financial year exceed five per cent of average net profits for the three immediately preceding financial years
	S 186 (1)	Corporate investments to be carried out through no more than two layers of investment companies (with certain exceptions related to acquisition of foreign companies, etc)
	S 188 R 12 - 15	Related party transactions (other than in the ordinary course of business and not on 'arm's length' basis) of not less than the prescribed size need to be approved as a special resolution requiring super-majority of 75%, without the interested members voting their shares
	S 192 (1)	Directors and their connected parties not to acquire from or sell to the company any assets for consideration other than cash unless approved by members in general meeting
	S 194	Directors and Key Managerial Personnel not to engage in forward transactions in securities of the company, its holding, subsidiary or associate companies
	S 195	Prohibition of Insider Trading by Directors and Key Managerial Personnel; exemplary punishment for breach: fine up to Rs 250 mn and/or imprisonment up to five years

Governance Theme	Companies Act 2013	
	Reference	Provision
	S 149 (1) R 11 - 3	Non-Listed Public Companies with a paid up capital of Rs 1,000+ mn, or turnover of Rs 3,000 mn, to have at least one woman director on their board
Boards & Processes	S 149 (4) R 11 -4	Non-Listed Public Companies with a paid up capital of Rs 100+ mn, or turnover of Rs 1,000 mn, or aggregate of borrowings, loans, debentures or deposits of Rs 500 mn, to have at least two independent directors on their board
	S 149 (6) S 149 (7)	Criteria of independence set out; nominee directors not to qualify as <i>independent</i>
	S 149 (8) Sch. IV	Company and independent directors to abide by the detailed Code provisions in the Schedule that cover their role, duties, appointment, resignation, performance evaluation, and so on)
	S 149 (9)	Independent directors not eligible for stock options
	S 149 (10) S 149 (11) S 149 (13)	Not more than two consecutive terms of five years each as <i>independent directors</i> ; thereafter, three years cool-off period prescribed to qualify for reappointment as independent; no association with the company in any capacity, directly or indirectly, during the cool-off period ; independent directors exempted from retirement by rotation provisions
	S 149 (12)	Limitations on liability of independent directors for acts of omission and commission
	S 161 (1) S 161 (2)	Persons failing to get elected at a members' meeting barred from being appointed by the board as additional directors or alternate directors
	S 165 (1)	Persons not to be directors in more than twenty companies, of which no more than ten may be public companies
	S 173 (3)	In the absence of all independent directors from a meeting of the Board (convened at short notice of less than seven days), decisions taken at such a meeting must be circulated to all the directors and shall be final only on ratification by at least one independent director
	S 177 (2)	Non-listed public companies with paid-up capital of Rs 100+ mn, or turnover of Rs 1,000+ mn, or aggregate of borrowings, loans, debentures and deposit of Rs 500+ mn, to have audit committees of at least three directors, with a majority of them being independent and (including its chairman) financially literate
S 178 (1)	Non-listed public companies with paid-up capital of Rs 100+ mn, or turnover of Rs 1,000+ mn, or aggregate of borrowings, loans, debentures and deposit of Rs 500+ mn, to have Nomination and Remuneration Committees of at least three non-executive directors half of whom shall be independent directors, and the board chairman being barred from chairing the committee	
	S 203 (1) R 13 - 8	Public companies , with a paid-up capital of Rs 100+ mn not to combine managing director and board chair positions unless provided otherwise by their articles or they carry on multiple businesses with separate CEOs for each such business. Such companies also to appoint whole time key management personnel (CFO, Company Secretary, CEO or a Manager, or a whole time director

<b>Governance Theme</b>	<b>Companies Act 2013</b>	
	<b>Reference</b>	<b>Provision</b>
<b>Financials, Disclosure &amp; Reporting</b>	S 129 (1) Sch. III	Substantial enhancement of financial and operational details required to be provided with financials
	S 129 (3)	Companies with subsidiaries, joint ventures or associate companies required to produce consolidated accounts in the format applicable to them, following consolidation principles to be prescribed; and provide a statement containing the salient features of the financials of its subsidiaries
	S 130 S 131	Provisions relating to revision and restatement of accounts introduced
	S 132 (2)	National Financial Reporting Authority to advise on Accounting Policies and Standards, monitor and enforce compliance
	S 134 (3)	Significant enhancement of disclosure requirements in Directors' report to shareholders (including a CSR report, directors' responsibility statement, policy statement on criteria of appointment and remuneration of directors, and so on)
	S 139 (2) S 139 (3)	Auditors to be appointed for a term of five years (if an individual) or two such consecutive terms (if a firm) after which they (and firms with commonality of their partners) may not be appointed for the same company for a cool-off period of five years; in case of firms, shareholders may decide the frequency (if any) of rotation of audit partners within the firm in charge of the audit
	S 140 (2)	An auditor resigning before the end of the term to mandatorily file with the company and the Registrar (and the C&AG in certain cases) a statement of reasons and other relevant matters that led to the resignation
	S 140 (5)	By a special resolution, an auditor may be removed or not reappointed even when otherwise eligible; the government or the Tribunal may also direct the company to remove or not to reappoint the auditor, if convinced such action is justified; in that even the auditor or audit firm will be debarred from appointment as auditor of the company for a period of five years from the order