Business Ethics and Corporate Governance

Block

5

CORPORATE GOVERNANCE

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Block V

Corporate Governance

The fifth block of the course on Ethics and Governance deals with corporate governance. The block contains five units. The first unit discusses about corporation. The second focuses on corporate governance. The third unit discusses the board structures and styles. The fourth unit discusses the roles and responsibilities of the board of directors. The fifth unit discusses the codes and laws pertaining to corporate governance.

The first unit, Corporation - An Overview, discusses the various definitions of the word 'corporation', and the basic purposes of a corporation. It discusses how to evaluate the corporate structure. The unit describes the concept of the corporation as aperson and as a moral person. The unit ends with a discussion on the expectations of society and the market from the corporation.

The second unit, Corporate Governance - An Overview, discusses the definition of corporate governance, and the various issues involved in it. The unit discusses the differences between corporate governance and corporate management. It also discusses the theories and models of corporate governance. The unit ends with a discussion on the evolution of corporate governance.

The third unit, Corporate Governance - Board Structures and Styles, focuses on the various types of directors and their respective functions. The unit discusses the different types of board structures based on the type of directors on the board. The unit also discusses the issues that need to be addressed by organizations while designing a board structure. The unit ends with a discussion on the various types of boards.

The fourth unit, Corporate Governance - Roles and Responsibilities of Board of Directors, focuses on the roles, responsibilities, and duties of directors. The unit also discusses the role and functions of the Chairman and the Chief Executive Officer. The unit ends with a discussion on the functions and committees of the board.

The fifth unit, Corporate Governance - Codes and Laws, focuses on the self-regulatory codes. The unit also discusses the various reports of committees on Corporate Governance such as the Kumar Mangalam Birla committee report, the CII report, the Cadbury report, and the OECD report. The unit ends with a discussion on the corporate governance and company law.

Unit 18
Corporation-An Overview

Structure

“Good corporate governance, it’s about being proper and prosper.”

\- Toba Beta, Author

18.1 Introduction

In the last unit of the previous block, we have discussed the role of business in society. In this unit, we shall discuss about corporation.

A corporation helps obtain capital to create wealth. It facilitates an increase in international trade, thereby increasing employment opportunities and encouraging rapid business development. In the early 19th century, business was carried out in three ways as a sole proprietorship under contract law; as partnerships as per the partnership act; or as an unlimited and unincorporated company.

The owners of unincorporated companies were held personally liable for the debts if the business failed. This unlimited liability discouraged the owners from investing capital in unincorporated business ventures. It is this limitation that brought into existence the Joint Stock Companies. Under this form of business, the liability of investors is limited to the amount invested. The first country to pass the Joint Stock Companies Act was the UK, which passed this Act in 1844. Later, this act became the framework for the company law in Hong Kong, India, New Zealand, Singapore, South Africa, Australian states, and the Canadian provinces. The evolution of Joint Stock Companies also came to form the basis for corporate governance.

The actual concept of the corporation is simple and successful. Its boundaries, functions, and purpose can be easily defined. The corporate boundary is defined as the separation of business from owners and incorporation of business as an independent legal entity. The corporate cover helps companies limit the shareholders' liabilities to the amount of their initial equity capital in case of business failure.

The corporation is able to act independently of its owners, and the owners are able to transfer their shares. As it is recognized as a person under law, it is able to act like a person and own, buy, and sell assets; incur debts; employ people; and sue and be sued.

As ownership determines the system boundaries, it forms a base for power over the company. Some of the powers of owners of a corporation are -- they can nominate and elect directors to manage the company on behalf of the shareholders; they can make the directors accountable for their actions; and they can cross check the information (accounts, reports, etc.) submitted by the directors by appointing independent auditors. The corporate concept suggests that power is derived from ownership, and thus owners should exercise that power based on their investment.

This unit will first discuss the various definitions of the word 'corporation', and the basic purposes of a corporation. We shall then move on to discuss how to evaluate the corporate structure. We shall also discuss the concept of the corporation as a person and as a moral person. Finally, we shall discuss the expectations of society and the market from the corporation.

18.2 Objectives

By the end of this unit, you should be able to:

- Define the word 'corporation'
- Explain how to evaluate the corporate structure.
- Recognize the basic purposes of a corporation.
- Discuss the concept of the corporation as a person and as a moral person. Identify the expectations of society and the market from the corporation.

18.3 Definitions of the Word 'Corporation'

Given here are some of the definitions of 'Corporation'.

In the words of John Marshall, –"A corporation is an artificial being, invisible, intangible, and existing only in the contemplation of the law." Being the mere creature of the law, it possesses only those properties, which the charter of its creation confers on it, either expressly or as incidental to its very existence. These are such as are supposed best calculated to effect the object for which it was created. Among the most important are immortality, and, if the expression be allowed, individuality, properties by which a perpetual succession of many persons are considered the same, and may act as a single individual.

Another definition is given by Melvin Avon Eisenberg. According to him, "The business corporation is an instrument through which capital is assembled for the activities of producing and distributing goods and services and making investments." Accordingly, a basic premise of corporation law is that a business corporation should have as its objective the conduct of such activities with a view to enhancing the corporation's profit and the gains of the corporation's owners, that is, the shareholders.

The definition of Blackstone says, "When they (the individuals composing a corporation) are consolidated and united into a corporation, they and their successors are considered as one person in law, a person that never dies; in like manner as the river Thames is still the same river, though the parts which compose it are changing every instant."

The corporation has the ability to attain resources from various groups, and to create and maintain a corporate personality distinct from other groups. A corporation is a mechanism that enables different groups to contribute capital, skills, and labor for pursuing their own interests. The individual who invests in a corporation can take his/her part of the profits without actively participating in the company operations.

The management runs the company on behalf of the shareholders. Though it is an independent entity, a corporation comprises directors, managers, employees, shareholders, customers, creditors, suppliers, members of the community, and the government. Corporations maintain distinct relationships with their constituents. The direction and focus of a corporation is influenced by its individual relationships.

Example: Tata Motors Acquisition of Ford Motor Unit

American carmaker 'Ford Motor Company' started its car manufacturing units in India as the management had foreseen the country as one of its three biggest markets in the world. But, in September 2021, the company's stakeholders decided in a meeting to cease the company's car manufacturing units in India. The decision was taken due to huge and irreparable losses (more than $2 billion) incurred by these units during the past 10 years. The decision outcome was the closure of the company's two plants and local assembling of parts with immediate effect, affecting 4000 jobs.

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On 8th August 2022, Indian carmaker 'Tata Motors Limited' as its manufacturing capacity reached saturation levels, decided to acquire Ford's plant at Gujarat, India. The decision was taken by its stakeholders to acquire the unit for $92 million (i.e., 7.26 billion rupees). It was the acquisition of land and building, vehicle manufacturing plant and machinery, eligible employees, etc. The stakeholders, through this acquisition, wanted to bolster the company's yearly manufacturing capacity from 3 million units to 4.2 million units. The acquisition was part of their drive to develop a manufacturing hub for its electric vehicles (foreseen growing market) manufacture.

So, Tata Motors Limited decided to acquire Ford Company's capital and assets, to bolster its manufacturing capacity. And, Ford Company decided to sell its Indian unit to Tata Motors Limited to stop its unprofitable venture and to cover broadly its losses through this sale. Both the decisions were taken by the company's stakeholders on behalf of the company.

Source:https://www.bloomberg.com/news/articles/2022-08-07/tata-motors-agrees-to-buy-ford-s-gujarat-plant-for-92-million, dated: 8th August, 2022, accessed on 9th September, 2022.

18.4 Evolution of the Corporate Structure

The Darwinian process led to the development of the corporate structure. The corporate structure was designed to meet society's needs that were not being met by earlier business models. In every next stage of development, the corporate structure was made stronger and more unreachable to outside control (difficult to take over.)

The evolution stages of the corporation aimed at its perpetuity and growth. Perpetual existence was given to municipal and educational corporations in the early Anglo- Saxon approach of corporate governance. These corporations applied control over their own functions to get freed from the kings' power. The states of the 17th century created corporations for specific purposes. In Britain, corporations were created to lead colonies in India and America. An example of such a corporation was the British East India Company that was initially created to carry out trade with the East Indies, but later ended up trading with India and China. The limited liability of these attracted huge investments.

18.4.1 Characteristics of Corporations

In the late 19th century, three developments took place that led to the need for flexibility in corporations:

- Economies of scale gained from the use of emerging technologies encouraged firms to go in for mass production. This resulted in large firms having to employ huge workforces.
- There was the need for a greater number of investors to support larger firms.

- There was the acceptance of private ownership of private property as a social norm.

Following are the characteristics of a corporation.

Limited liability

Limited liability was prevalent in 2000 BC, when merchants financed sea vessels in return for a share in the profits resulting from trade. In case of a shipwreck, however, their loss was limited to the amount invested. This term was first used by the English courts in the 15th century, with limited liability implying that the corporation was distinct from its owners and employees. That is, what was owed to the corporation was not owed to the individuals and what was owed to the individual was not owed to the corporation. If a corporation became bankrupt and creditors sued it, the membersof the corporation were not held individually liable. The risk of loss was limited to the amount invested. Partners had equal rights in the running of the business. The partner's liability could be matched to his/her share of power. Relatively, the shareholder enjoyed a lower level of risk.

Transferability

Transferability of stockholding attracts investment and provides limited authority/riskto the shareholder. The free transfer of shares enables a shareholder to reduce his/her risk level. A shareholder can control his/her own risk/authority by selling his/her stock when it is losing value.

Legal personality

A corporation is a legal person, and can exist as long as it has capital to run its business. Following are its rights --

- Corporations give reasonable protection to individuals working for it from penalty or jail, which they would not enjoy as outsiders.
- Corporations can make donations to political parties and thus, can push for anagenda favoring them.
- Corporations can own property, including real estate, copyrights, and intellectual property.

Example: TCS Move as a Legal Entity

To cope up with Covid pandemic stuck in the year 2019, TCS (Tata Consulting Companies), India's largest exporter of IT (Information and Technology) services, adopted WFH model (work from home model) for its employees. This model brought laurels to the employees' efforts as in this regime TCS profits touched around $1 billion dollar (second quarter of FY 2020-2021) for the first time.

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However, owing to the need of employees in the office, TCS announced 25/25 model (hybrid model) in April 2020. It was a 25/25 model because 25 percent of TCS employees should work from office location at any given point of time, need to spend 25% of their time in the office, and 25% of its project team will be co-located.

25/25 model faced hindrances in its execution as it needed strict control framework. For such framework, TCS needed at least 80% of staff to resume their office. It planned to develop a structured hybrid working model by 2025.

As the covid cases declined and the maximum population got partially vaccinated, TCS started a new model 'return to Office' model to substitute the WFH model and to lay a structure for its hybrid model. On 25th August 2022, TCS, as a legal entity officially made an announcement for all its employees to resume their work from office by 15th November 2022.

Sources:

(i) https://www.gadgetsnow.com/slideshows/tcs-reports-1-billion-profit-10-things-to-know/beats-market-expectations/photolist/61067440.cms, dated: 3rd November, 2020, accessed on 9th September, 2022.

(ii)https://www.moneycontrol.com/news/business/20-of-tcs-employees-work-out-of-office-company-wants-to-increase-it-to-80-8800941.html, dated: 8th July, 2022, accessed on 9th September, 2022.

(iii)https://www.news18.com/news/business/tcs-work-from-home-it-giant-asks-employees-to-return-to-office-know-latest-guidelines-5824213.html, dated: 26th August, 2022, accessed on 9th, September 2022.

Centralized management

In a corporation, the board of directors is authorized to plan the company's overall direction, and empower managers to manage its daily operations. The limited authority given to the investors in daily operations lead to the corporation's activities being centrally managed. Shareholders exercise their right to take decisions on general issues, thus enabling the company to operate with maximum efficiency.

Earlier, the state gave approval to the corporations and granted them the charter, which would enable them to engage in business activities. By the late 19th century, corporationswere lawfully allowed to manage their activities without government approval. This change influenced the relationship between corporations and their shareholders. The number of shareholders increased, leading to a spread of ownership. As the size and ageof the corporations increased, the liquidity in the market also increased.

Check Your Progress - 1

1. Which of the following is a benefit of a corporation/?
   i. Impedes tapping of large amounts of capital
   ii. Helps in increasing international trade
   iii. Increases employment opportunities
   iv. Encourages rapid business development
   a. Only i, ii and iii
   b. Only i, ii and iv
   c. Only i, iii and iv
   d. Only ii, iii and iv
2. Which of the following is not a business form prevalent in the early nineteenth century?
   a. Sole proprietorship under contract law
   b. Partnerships as per partnership act
   c. Unlimited and unincorporated company
   d. Joint stock companies
3. In the case of which of the following, the owners were held personally liable for the debts when the business failed?
   a. Corporation
   b. Joint stock companies
   c. Unincorporated companies
   d. Limited companies
4. According to the Joint Stock Companies Act passed in 1844, what was the liability of the investors in a joint stock company?
   a. Unlimited if the business failed
   b. Limited to the extend they can pay if the business failed
   c. Always unlimited
   d. Limited to the amount invested
5. The corporate cover given to companies helped them limit the _________________of the shareholders to the amount of their _________________in case of business failure.
   a. Assets, total investment
   b. Liability, initial equity capital
   c. Assets, initial equity capital
   d. Liability, total investments
6. Owners of a corporation have the power to:
   a. Nominate and elect directors to manage the company on behalf of the shareholders
   b. Make the directors accountable for their actions
   c. Cross check the information submitted by the directors by appointing independent auditors

a. Only i and ii
b. Only i and iii
c. Only ii and iii
d. i, ii and iii

7. Which of the following statements is false about a corporation?
   i. It is an instrument through which capital is assembled for the activities of producing and distributing goods and services and making investments
   ii. It is an artificial being or legal entity created by, or under the authority of, the laws of a statement.
   iii. It is indistinguishable from the individuals who comprise it.
   a. Only i
   b. Only i and ii
   c. Only ii and iii
   d. Only iii
8. The Corporations maintains which form of relationships with their constituents?
   a. Imprecise
   b. Indistinguishable
   c. Distinct
   d. Casual

18.5 Purpose of a Corporation

Corporations carry out a lot of activities and serve to fulfill a number of purposes. To a very large extent, they determine the quality of life. Given here are some of the activities of corporations.

18.5.1 Human Satisfaction

Corporations help individuals satisfy their basic needs of security, success, and fulfillment. They enable individuals to market their skills and experience and get due rewards. They enable ambitious individuals to achieve, enterprising individuals to prosper, and ingenious individuals to develop themselves. A well-designed corporation enables individuals to create more wealth.

18.5.2. Social Structure

Earlier, social structures were created to develop cooperation and specialization, without any financial goals. The end of World War I saw a gradual shift in power from hereditary rulers to a new social structure, i.e., the corporation. Corporations produced the goods and services desired by the citizens backed by purchasing power.

18.5.3. Efficiency and Efficacy

The efficiency and efficacy of a corporation are determined by the quality of work that it puts in to achieve its objectives. Efficiency is the productivity of a person, achieved through minimum effort, and efficacy implies the ability to produce the desired result. Efficiency and efficacy are associated with words like professional, enterprise, and business-like. To fulfill the society's needs. it has become inevitable to follow a corporate structure.

18.5.4. Ubiquity and Flexibility

Corporations provided flexibility to employees to perform better. They are perpetual entities, can carry out their business activities worldwide, are movable, and can be transformed with an alteration of legal or financial structures. The place of incorporation can also be changed nearer to other existing business locations, and new businesses can be opened without reallocating the capital amount. Corporations cannot be jailed, but can be fined. As corporations are considered to be a major source of employment, they command respect in the competitive world.

18.5.5. Identity

Corporations live and exercise rights and powers like normal citizens. As a 'person', the property of a corporation is protected. Corporations can contribute money to political parties, and can play a vital role in discussions on enactment of various laws.

Example: Stake Significance 'in' Corporate's Identity

On 23rd August 2022, Adani Group acquired 100% stake in Vishwapradhan Commercial Private Limited (VCPL) and unveiled its plans to acquire a majority stake in New Delhi Television Limited (NDTV). This was not a sudden announcement as its intent acquisition home work started when Adani Group found unpaid RRPR debt in VCPL books.

In the year 2009-10 (i.e., prior to acquisition), VCPL had given a loan of Rs.403.85 crore to RRPR Holding Private Limited (RRPR), an NDTV promoter. The loan was given against the issue of convertible warrants. In case of loan default, VCPL could convert these warrants into 29.18 per cent equity stake in NDTV. RRPR's loan default laid a path for 'VCPL acquired Adani Group' and exercised the option for 29.18 percent stake in NDTV. Both the regulators, Income-tax Department and SEBI, saw no legal constraint for this conversion.

To acquire NDTV, VCPL needs at least 51% equity stake. So, it launched an open offer for tendering an additional 26% stake from the NDTV stakeholders.

On successful completion of open offer, NDTV identity gets lost to the VCPL acquired Adani Group.

Sources:

(i) https://www.business-standard.com/article/news-cm/adani-enterprises-acquires-100-stake-in-vcpl-122082301011_1.html, dated:23rd August, 2022, accessed on 12th September, 2022

(ii) https://timesofindia.indiatimes.com/business/india-business/ndtv-promoter-rrprh-seeks-clarity-from-sebi-on-conversion-of-warrants-issued-to-adani-firm/articleshow/93860620.cms, dated:29th August, 2022, accessed on 12.09.22

(iii) https://www.livemint.com/market/stock-market-news/sebi-sees-no-hurdle-to-share-transfer-in-adani-ndtv-tussle-11661712485903.html, dated: 29th August, 2022, accessed on 12th September, 2022.

18.6 Corporation as a 'Moral Person'

Attempts have been made to establish corporations as 'persons'. For years, corporate lawyers had been trying to ascertain complete citizenship for business organizations. They were of the view that corporations should be given similar political and voting rights that are given by the constitution to the citizens. In 1886, US corporations were regarded as persons under the due process amendment. Corporate lawyers, in the later years, continued to stress the Bill of Rights, which would protect organizations from federal laws.

Example: Sequoia 'on its' Corporate Governance

Sequoia Capital India Advisors Private Limited, Capital Market Company, noticed that most of its high-profile start-ups (includes Fintech, Bharatpe, Trell and Zilingo) fell under corporate governance scanner. They were alleged to have committed the willful misconduct and financial fraud.

Sequoia, as a legally vetted person, took this seriously and held that it will respond to the allegations strongly. On 18th April 2022, it decided to take proactive steps to increase its corporate governance compliances. For this, it planned to

- Conduct the corporate governance training for its founders and senior management cadre,
- Ensure the execution of whistle-blower policies,
- Appoint more independent directors on the board (Board of Directors),
- Increase the number of disclosures, have a rigorous internal audits and internal controls.

Source: https://economictimes.indiatimes.com/tech/newsletters/morning-dispatch/logistics-wars-out-in-the-open-sequoia-breaks-silence-on-corporate-governance/articleshow/90901485.cms, dated:18th April, 2022, accessed on 12th September, 2022.

Check Your Progress - 2

9. Corporate structure was developed gradually through which of the following processes?
   a. Darwinian
   b. Dawdles
   c. Marshall
   d. Ambrose
10. Which of the following development of late nineteenth century raised the need forbuilding some flexibility in the corporation?
    i. Economies of scale resulting from the use of emerging technologies

ii. Need for a greater number of investors to support larger firms.
iii. Acceptance of private ownership of public property as a "social norm."
a. Only i and ii
b. Only i and iii
c. Only ii and iii
d. i, ii and iii

11. The basic characteristics of a corporation, which attracts investors are
i. Limited liability for investors
ii. Decentralized management
iii. Free transferability of investor interests
iv. Legal personality
a. Only i, ii and iii
b. Only i, ii and iv
c. Only i, iii and iv
d. Only ii, iii and iv

12. Which of the following statements about transferability of stock is false?
a. Transferability of stockholding attracts investment.
b. The facility of free transfer of shares enables a shareholder to minimize the levelof risk.
c. Transferability provides the advantage of limited authority/risk to the shareholder.
d. The shareholder tries to control his/her own risk/authority by buying shares whenthey are losing value.

13. Rights enjoyed by a corporation are-
i. Corporations can give reasonable protection to individuals working for it frompenalty or jail, which individuals would not enjoy as outsiders to the corporation.
ii. Corporations can make donations to political parties and thus can push an agendain favor of it.
iii. A corporation can own property, including real estate, copyrights and intellectualproperty.
a. Only i and ii
b. Only i and iii
c. Only ii and iii
d. i, ii and iii

14. Which of the following activities are performed by a corporation?
i. Achieve human satisfaction
ii. Build social structure
iii. Achieve efficiency and efficacy
iv. Limited and firm
a. Only i, ii and iii
b. Only i, ii and iv
c. Only i, iii and iv
d. Only ii, iii and iv

15. Shareholders exercise their right to take decisions on ____, thereby enabling the company to operate with ____________________ efficiency.
    a. Specific issues, minimum
    b. General issues, maximum
    c. Day to day operations, maximum
    d. Overall directions, minimum
16. Which of the following statements is false?
    a. Business corporations help human beings satisfy their basic needs of security,success and fulfillment.
    b. A corporation restricts individuals and does not allow creation of wealth.
    c. Corporations enable individuals to market their skills and experience and get duerewards.
    d. In a corporate environment, ambitious individuals can achieve, enterprisingindividuals can prosper, and ingenious individuals can enrich themselves.

18.7 Corporation-Expectations of Society

A moral decision-making process has to be adopted by a corporation to qualify as a 'moral person'. The moral decision-making process includes -- the ability to use moral reasons while making decisions; and the ability of the decision-making policy to control not only the explicit corporate acts, but also the structure of policies and rules.

Corporations have the ability to use moral reasons while taking decisions. This makes them superior to machines. To show that they are morally accountable, corporations should show moral reasons for their activities and actions, though they do not think as humans. They should maintain a proper internal structure that can give an account of their behavior like humans. Apart from being morally accountable, corporations should know whether they will do well by doing good things.

Example: Swiggy's 'Permanent Work from Anywhere Policy'

On 29th July 2022, Swiggy, India's leading food delivery company, had introduced a new work policy 'permanent work from anywhere policy'. This entitles the employee to continue to work remotely but meeting once in a quarter at the company's base location to promote in-person bonding. The company took this initiative after consultation with its employees, managers and teams. They all wanted the flexibility in their work within the contours of their job and the company considered this after taking their consensus of working to increase the company's productivity as they had done during 'work

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from home policy' that prevalent over the 2020 and 2021, the two years of Covid pandemic.

Swiggy's decision gained significance because this was taken at the time when the Covid lost its pandemic and all other companies were demanding their employees to work from office. Thus, within this policy adoption, there existed a moral and profitable strategy of Swiggy.

Sources:
(i)https://www.business-standard.com/article/companies/swiggy-announces-permanent-work-from-anywhere-policy-for-most-roles-122072900592_1.html, dated: 29th July, 2022, accessed on 12th September, 2022.
(ii)https://timesofindia.indiatimes.com/gadgets-news/swiggy-announces-permanent-work-from-anywhere-policy-who-will-have-to-come-to-office-and-not/articleshow/93213566.cms, dated: 1st August, 2022, accessed on 12th September, 2022

18.8 Corporation - Expectations of Society

Society expects jobs, salary, goods, and services that satisfy their needs from corporations. It invites challenges from corporations to show creativity and ingenuity. Corporations are also expected to work with society to maintain a healthy environment. Society expects a guarantee of growth and progress from corporations. It has a stake in the company, as an employee, shareholder, customer, supplier, creditor, or neighbor.

Two related sets of laws govern the relationship between the corporation and its stakeholders. The first set involves laws that are enacted by the legislature. These laws form the basis for setting up minimum standards, and enable corporations and their governing bodies to function with maximum flexibility. The government interferes only when the system of corporate governance fails to safeguard the society's interests.

In reality, governments and corporations influence each other. The corporate 'citizen' influences the laws that affect his/her 'citizenship'. In theory, corporations assist the free market, with minimum interference from the government. But in practice, corporations influence the government to pass laws that set barriers to protect them from competition in the free market. Laws establish corporate governance standards, but the standards obtain value only when they provide accountability. Mostly quorum rules are designed to feature a healthy representation of the investors on the boards, while discouraging lifetime directorships. It also requires a majority of the investors to participate on critical decisions. Directors and shareholders expect major transactions to be presented to the board rather than getting approved by managers or a committee.

Example: Supertech's Twin Towers Demolition

On 28th August 2022, Supertech Limited's Twin Towers in the Supertech Emerald Court Society premises in Noida got demolished. The company's

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failure to comply the construction norms led the Supreme Court of India to pass a demolition order. The court passed this order on a case filed by the residents of Emerald Society against their builder 'Supertech Limited'.

According to the complaint the building construction differed from that of its building plan such as the towers were actually constructed on the area where the garden was initially planned, failed to maintain the minimum distance requirement between the towers, individual flat owners consent was not taken before making any additional construction. The court on finding the allegations as true passed the demolition order in favour of society residents. The court also ordered the builder 'Supertech Limited' to fully refund the amount with interest to all those who purchased a flat in the Twin Towers.

Here, the corporate governance issues at Supertech Limited faced serious repercussions as it affected the resident interests in the society at large and statutory non-compliances

Sources:

(i)https://www.ndtv.com/india-news/supertech-noida-twin-towers-set-for-demolition-blast-evacuation-on-10-facts-3293149, dated:28th August, 2022, accessed on 12th September, 2022.

(ii)https://zeenews.india.com/india/explained-why-are-noidas-supertech-twin-towers-being-demolished-know-how-it-all-unfolded-2502285.html, dated: 28th August, 2022, accessed on 12th September, 2022.

Activity: Corporations exist and operate with the help of various inputs sourced from the society and produce various goods and services for the well-being of society. In this context, briefly explain the relationship between the corporation and the society and the laws governing this relationship.

Answer:

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18.9 Corporation-Expectation of the Market

A corporation's operations are influenced by market laws and its final performance is judged at the marketplace. The decisions of the directors and officers are controlled by market laws, irrespective of the company's location and production capacity. This is known as the law of economies. For example, a change in the company's state of incorporation to take advantage of taxation is a function of economies. Another example of the law of economies is the various social laws of states and nations that govern occupational safety and environmental standards. Corporations are very careful when selecting their location, especially when they have to choose between establishing a factory locally or abroad. All the costs and benefits are evaluated before selecting a location.

Activity: Chetan Singh (Chetan) established a mid-sized company that manufactured organic food products called ACS Organics Limited (ACS) in Chennai. During the first two years, the company ran into losses as the concept of organic food products was new to the market. However, in early 2020, the market picked up. ACS break even in 2021, and started earning good profits from early 2022. Chetan was happy with performance of his company, and shared the profits to ACS. He also wants to share profits with society. In one way, his company had already contributed to society by coming out with good products, and by providing employment opportunities to the locals. Suggest other ways in which the company can contribute to the society, apart from those mentioned.

Answer:

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Check Your Progress - 3

17. In a corporate environment, ____________________ individuals can achieve, ____ individuals can prosper, and ___________individuals can enrich themselves.
    a. Ambitious, enterprising, ingenious
    b. Enterprising, ambitious, ingenious
    c. Ingenious, enterprising, ambitious
    d. Ambitious, ingenious, enterprising

18. Which of the following statement is true?
    i. Efficacy is the productivity of person, which is achieved with minimum effort.
    ii. Efficiency implies the ability to produce the desired result.
    iii. “Professional” Efficiency and efficacy are associated with words like “enterprise”, and “business like”.
    iv. The quality of work put in by corporations for achieving their objectives determines their efficiency and efficacy.

a. Only i and ii
b. Only i and iii
c. Only ii and iv
d. Only iii and iv

19. Which of the following statements is false?
    a. Corporations provide flexibility to individuals enabling them to perform better, asthey do not maintain limit in time or space.
    b. Corporations are perpetual entities but they cannot carry out their businessactivities anywhere in the world.
    c. Corporations are movable, and with a revision of legal or financial structures,they can be transformed.
    d. The place of incorporation of a corporation can be changed nearer to otherexisting business locations.
20. The process of moral decision-making includes which of the following?
    i. the ability to use moral reasons in decision-making
    ii. The ability of the decision-making policy to control the explicit corporate acts
    iii. The ability to control the structure of policies and rules of the decision-making policy
    a. Only i and ii
    b. Only i and iii
    c. Only ii and iii
    d. i, ii and iii
21. Which of the following is an expectation of the society with the corporation?
    i. Goods and services that satisfy their needs
    ii. To exhibit monotony
    iii. To maintain a healthy environment
    iv. Growth and progress
    a. Only i, ii and iii
    b. Only i, ii and iv
    c. Only i, iii and iv
    d. Only ii, iii and iv
22. The laws enacted by the legislature forms the basis for establishing ______and enable corporations and their governing bodies to function with______flexibility.
    a. Minimum standard, maximum
    b. Moderate standard, minimum
    c. Utmost standard, maximum
    d. Supreme standard, minimum

23. Which of the following statement is false?
    i. Corporations are unable to assist the free market, without the interference fromthe government.
    ii. Corporations persuade the government to pass legislations that set barriers toprotect them from competition in the free market.
    iii. Laws establish the standards of corporate governance.
    a. Only i
    b. Only ii
    c. Only iii
    d. Only i and iii
24. Which of the following laws influence the decisions of directors and officers, irrespective of the company's location and production capacity?
    a. Innovation
    b. Attraction
    c. Nature
    d. Economies

Activity: Chetan Singh (Chetan) established a mid-sized company that manufactured organic food products called ACS Organics Limited (ACS) in Chennai. During the first two years, the company ran into losses as the concept of organic food products was new to the market. However, after 3 years, the market picked up. ACS broke even in the fourth year, and started earning good profits from early fifth year. Chetan was happy with performance of his company, and shared the profits

With his employees and shareholders. He also wanted to share the company's profits with society. In one way, his company had already contributed to society by coming out with good products, and by providing employment opportunities to the locals. Suggest other ways in which the company can contribute to the society, apart from those mentioned.

Answer:

18.10 Summary

- Corporations are legal entities in the eyes of the law. They can borrow money, enter into contracts, own property, and sue and be sued like individuals. The operations of corporations are carried out independent of any individual member.
- Gradual improvements in the corporate structure enabled corporations to meet the specific needs of business that were not being met earlier. Changes that occurred at every stage helped corporations to establish their own perpetuity and growth.
- As corporations started growing, they acquired certain characteristic features that distinguished them from other business organizations. These are -- limited liability for investors, free transferability of investor interests, legal status as 'person', and centralized management.
- A corporation is considered to be one of the most pervasive elements in society that influences everyday life. It determines the quality of life; achieves efficiency and efficacy while serving society; enables individuals to perform better by being ubiquitous and flexible; and maintains its identity as an individual.
- The corporation as a 'person' and as a 'moral person' plays a significant role in achieving business objectives, morally.
- A corporation works for the welfare of society by providing employment opportunities, meeting the interests of various groups such as employees, shareholders, customers, suppliers, and creditors.
- The operations of a corporation are influenced by market laws and its final performance is judged at the marketplace.

18.11 Glossary

Corporation: A corporation is an artificial being, invisible, intangible and existing only in the contemplation of the law. Being the mere creature of the law, possesses only those properties, which the charter of its creation confers on it, either expressly or as incidental to its very existence.

18.12 Self-Assessment Test

1. A 'corporation' helps obtain capital to create wealth. It facilitates an increase in international trade, thereby increasing employment opportunities and encouraging rapid business development. Define a corporation. What are the expectations of a corporation from the society and the marketplace?
2. The corporate structure was designed to meet society's needs that were not met by earlier business models. Explain the evolution of the corporate structure. What are the characteristic features of a corporation?

3. Corporations carry out a lot of activities and determine the quality of life. Describe in detail the various activities carried out by a corporation.
4. "Corporation as a 'person' and as a 'moral person' plays a significant role in achieving business objectives, morally. Substantiate this statement.
5. Corporations are also expected to work with society to maintain a healthy environment. Explain the expectations of the society from a corporation.
6. A corporation's operation is influenced by market laws and its final performance is judged at the marketplace. Explain the expectations of a market from a corporation.

18.13 Suggested Readings / Reference Material

1. K P Muraleedharan, E K Satheesh (2022). Fernando's Business Ethics and Corporate Governance, Pearson India. 3rd edition
2. Manuel G. Velasquez (2021). Business Ethics – Concepts and Cases. Pearson Education, 8th edition
3. K Viyyanna Rao & G Naga Raju (2020). Business Ethics and Corporate Governance. 1st edition. Wiley
4. Jyotsna GB & RC Joshi (2020). Business Ethics and Corporate Governance. McGraw Hill India. 1st edition
5. Sandeep Goel (2020). Corporate Governance. McGraw Hill India. 1st edition

18.14 Answers to Check Your Progress Questions

1. (d) Only ii, iii and iv

A "corporation" facilitates tapping of large amounts of capital in order to create wealth. It helps in increasing international trade, thereby increasing employment opportunities. It also encourages rapid business development.

2. (d) Joint stock companies

In the early nineteenth century, business was carried out in three ways -- as a sole proprietorship under contract law; as partnerships as per partnership act; or as an unlimited and unincorporated company. In all these business forms, owners were held personally liable for the debts when the business failed. This unlimited liability on the part of owners discouraged them from investing capital in unincorporated business ventures. The Joint Stock Companies Act, passed in 1844 by the British gave a new form of running the business where the liability of the investor was limited to the amount invested. According to the act, liability of the investors in a joint stock company was limited to the amount invested.

3. (c) Unincorporated companies

In the case of unincorporated companies, owners were held personally liable for the debts when the business failed. In a corporation, a joint stock company, and a limited company, the liability of the investor is limited to the amount invested in the business.

4. (d) **Limited to the amount invested**
According to the Joint Stock Companies Act passes in 1844, liability of the investors in a joint stock company was limited to the amount invested. The concept of limited liability was introduced to encourage investors to infuse fresh capital into new business ventures.

5. (b) **Liability, initial equity capital**
The corporate cover given to companies helped them limit the liability of the shareholders to the amount of their initial equity capital in case of business failure.

6. (d) **Only i, ii, and iii**
Owners of a corporation have the power to nominate and elect directors to manage the company on behalf of the shareholders. They can make the directors accountable for their actions and also cross check the information (accounts, reports, etc.) submitted by the directors by appointing independent auditors.

7. (d) **Only iii**
The corporation is an instrument through which capital is assembled for the activities of producing and distributing goods and services and making investments. It is an artificial being or legal entity created by, or under the authority of, the laws of a statement. The corporation is distinct from the individuals who comprise it. Hence option iii is false about the corporation.

8. (c) **Distinct**
The Corporations maintains distinct relationships with their constituents. It is associated with different constituents like directors, managers, employees,shareholders, customers, creditors, suppliers, members of the community and the government. The direction and focus of a corporation is influenced by its individual relationships.

9. (a) **Darwinian**
Corporate structure was developed gradually through Darwinian process. It was designed to meet certain needs of society that were not met by earlier business models.

10. (a) **Only i and ii**
Developments of late nineteenth century which raised the need for building in some flexibility in the corporation are: Economies of scale resulting from the use of emerging technologies made it possible for firms to go in for mass production. As a result, the need for large firms, employing large work forces was felt; Need for a greater number of

investors to support larger firms; and Acceptance of private ownership of private property as a "social norm."

11. (c) Only i, iii, and iv

The basic characteristics of a corporation which attracts investors are limited liability for investors, free transferability of investor interests, legal personality i.e. legal status as "person" and centralized management.

12. (d) The shareholder tries to control his/her own risk/authority by buying shares when they are losing value.

The facility of free transfer of shares enables a shareholder to minimize the level of risk. So, when a shareholder finds that his/her stock is losing value, he/she can sell his/her stock. The shareholder tries to control his/her own risk/authority by selling shares when they are losing value.

13. (d) i, ii and iii

A corporation is a legal person, enjoying the following rights: Corporations can give reasonable protection to individuals working for it from penalty or jail, which individuals would not enjoy as outsiders to the corporation; Corporations can make donations to political parties and thus can push an agenda in favor of it; A corporation can own property, including real estate, copyrights and intellectual property.

14. (a) Only i, ii, and iii

A corporation performs several activities such as it strives for human satisfaction by building long lasting social structure. The corporate structure is utilized towards achieving efficiency and efficacy while serving society. By being ubiquitous and flexible and not limited and firm, corporations aim at giving individuals a long-lasting result. Moreover, a corporation maintains identity as an individual and thus seeks protection from law.

15. (b) General issues, maximum

The shareholders exercise their right only to take decisions on general issues, thereby enabling the company to operate with maximum efficiency.

16. (b) A corporation restricts individuals and does not allow creation of wealth.

Business corporations help human beings satisfy their basic needs of security, success and fulfillment. Corporations enable individuals to market their skills and experience and get due rewards. In a corporate environment, ambitious individuals can achieve, enterprising individuals can prosper, and ingenious individuals can enrich themselves. A corporation enables individuals to create more wealth.

17. (a) Ambitious, enterprising, ingenious

In a corporate environment, ambitious individuals can achieve, enterprising individuals can prosper, and ingenious individuals can enrich themselves.

18. (d) Only iii and iv

The quality of work put in by corporations for achieving their objectives determines their efficiency and efficacy. Efficiency is the productivity of person, which is achieved with minimum effort. Efficacy implies the ability to produce the desired result. Thus, efficiency and efficacy are associated with words like "professional", "enterprise", and "business like."

19. (b) Corporations are perpetual entities but they cannot carry out their business activities anywhere in the world.

Corporations provide flexibility to individuals enabling them to perform better, as they do not maintain limit in time or space. Corporations are perpetual entities and can carry out their business activities anywhere in the world. Corporations are also movable, and with a revision of legal or financial structures, they can be transformed. The place of incorporation can also be changed nearer to other existing business locations and new businesses can be opened without reallocating the capital amount.

20. (d) i, ii and iii

The process of moral decision-making includes: the ability to use moral reasons in decision-making; the ability of the decision-making policy to control not only the explicit corporate acts, but also the structure of policies and rules.

21. (c) Only i, iii, and iv

The society expects more from corporations in terms of jobs, decent salary, goods and services that satisfy their needs. Society also invites challenges from corporations to exhibit creativity and ingenuity and not monotony. Corporations are also expected to work with society to maintain a healthy environment. Society seeks an assurance of growth and progress from corporations.

22. (a) Minimum standard, maximum

The laws enacted by the legislature forms the basis for establishing minimum standard. These laws enable corporations and their governing bodies to function with maximum flexibility. In other words, government's intervention is needed only when the system of corporate governance fails to safeguard the interests of society.

23. (a) Only i

Theoretically, corporations assist the free market, with minimum interference from the government. But in reality, corporations persuade the government to pass legislations that set barriers to protect them from competition in the free market. Though laws establish the standards of corporate governance, the standards acquire value only by providing a feeling of accountability.

24. (d) Economies

The laws of the marketplace influence the decisions of directors and officers, irrespective of the company's location and production capacity. This law is known as the law of economies.

Unit 19

Corporate Governance-An Overview

Structure

"We cannot be mere consumers of good governance, we must be participants; we must be co-creators."

Rohini Nilekani - Indian writer, author and philanthropist.

19.1 Introduction

In the previous unit, we have discussed about corporation. In this unit, we shall discuss about corporate governance.

With market forces increasingly replacing government controls, corporate governance has been gaining prominence in recent years. Companies see corporate governance as a prerequisite for attracting funds from foreign investors. Investors also want to ensure that the companies they invest in are not only managed properly, but also have proper corporate governance. They consider corporate governance as a control mechanism that ensures the optimum use of a company's resources.

There are some instances of companies which were efficiently managed but which faced problems due to poor governance. Corporate governance is thus an issue of agency function, i.e., how to ensure that the investors' interests are taken care of. This is not only in terms of the return on investment by effective management, but also in terms of ensuring that the enterprises do not indulge in unethical practices. Such practices may have adverse consequences on the stakeholders' long-term interests.

Corporate governance is concerned with the way companies are governed, as distinct from the way the businesses within those companies are managed. It addresses various issues facing the boards of directors, which relate to the interaction with top management, relationship with the owners, other stakeholders, and society at large. Corporate governance ensures corporate performance through involvement in strategy formulation and policymaking, and corporate conformance through top management supervision and accountability to the stakeholders.

This unit will first discuss the definition of corporate governance, and the various issues involved in it. We shall then move on to discuss the differences between corporate governance and corporate management. We shall also discuss the theories and models of corporate governance. Finally, we shall discuss the evolution of corporate governance.

19.2 Objectives

By the end of this unit, you should be able to:

- Define corporate governance, and discuss the various issues involved in it.
- Differentiate between corporate governance and corporate management.
- Explain the theories and models of corporate governance.
- Discuss the evolution of corporate governance.

19.3 Issues in Corporate Governance

Corporate governance is a set of policies, processes, and practices used to align the interests of the top management of companies with the interests of their shareholders (in particular) and other stakeholders and society at large. Corporate governance addresses three basic issues -- ethical issues, efficiency issues, and accountability issues.

Ethical issues deal with the problem of fraud. To achieve their goals of profit maximization, companies use fraudulent means. For instance, they may form cartels to put pressure on governments to modify public policy (to suit their interests) that may go against the interests of the individuals and society. Companies may resort to bribes, giving gifts to potential customers, and lobbying under the pretext of public relations to achieve their goal of maximizing long-term owner value.

Example: Ethical Issue Alleged in L & T's Corporate Governance

On 6th April 2022, the MCA (Ministry of Corporate Affairs) of India had sought information from Larsen and Toubro Limited (L & T), India's biggest engineering conglomerate, over the corporate governance issues raised by its former employee. The employee alleged that the company made salary deduction of its 30,000 employees during November 2003 and March 2008, with an assurance that they will be issued equity shares of L & T. But instead they were issued redeemable preference shares of L & T Welfare Company Private Limited (a unit of L & T), though the funds collected were used for L & T expansion. Towards this, L & T requested MCA for some time for reciprocation, because, the allegations pertained to the issue happened between 2003 and 2008. It sought time to probe into all its concerned like books of accounts, statutory filings, etc., before arriving to a decision.

Sources: (i) https://economictimes.indiatimes.com/news/india/india-probes-lts-employee-welfare-arm-for-alleged-fraud/articleshow/85297583.cms?from=mdr, dated: 13th August 2021, accessed on 24.08.22.

(ii) https://economictimes.indiatimes.com/news/india/mca-seeks-information-from-lt-on-alleged-governance-issues/articleshow/90671923.cms, dated: 6th April 2022, accessed on 24.08.22.

Efficiency issues deal with the performance of management. Management has to ensure the proper returns on shareholders' investments which are through mutual funds, retirement funds, and tax funds, shareholders are concerned with the management's efficiency as there is no control mechanism through which they can control the management's activities. The management is accountable to its various stakeholders. Accountability issues arise out of the stakeholders' need for transparency in the conduct of business. These issues are also concerned with social responsibility as a company's activities influence the workers, customers, and society.

The growing scale of companies and their style of functioning have raised many new issues that must be addressed by corporate governance. Some of these issues are -- the growth of private companies, the magnitude and complexity of corporate groups, the importance of institutional investors, rise in hostile takeovers, insider trading, litigations against directors, need for restructuring boards, and changes in auditing practices.

The growth of private companies and the growing complexity of corporate groups is one of the major concerns of corporate governance. Initially, limited liability companies were incorporated to raise outside capital. Later, these companies used their powers as a legal person under law to acquire other 'companies' shares. This led to the formation of new companies that took over the assets and liabilities of the original companies before closing them. The result was a rise in mergers and acquisitions activity.

Corporate groups have become more and more complex. Large organizations trade through subsidiaries and associated companies. The ownership structures of a few groups are easy to understand -- a small hierarchy of wholly-owned companies functioning under a parent company. However, many groups have complex structures that are characterized by shareholding by varied investors.

The group wholly or partly owns the companies in the group. Cross-shareholding between the group companies and cross-directorship are common. Corporate groups operating globally usually go in for such complex structures so as to facilitate management control and international tax planning, to limit financial disclosure, or due to some regulatory reasons. Such complex structures create difficulties in understanding the ownership, power, and influence over the group companies.

Corporate governance deals with the growing influence of institutional investors on companies, which creates suspicion among the minority investors. Minority investors believe that larger and more influential investors pressure the management of a company to act in their interests. Corporate governance also addresses issues like hostile takeovers (particularly management buy-outs), insider trading, imbalanced boards, and compliance with international accounting standards.

19.4 Definition of Corporate Governance

It is difficult to define corporate governance as it covers a large number of distinct economic phenomena. Given here are some definitions of corporate governance.

Organization for Economic Co-operation and Development (OECD) - Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as the board, managers, and shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance.

Advisory Board of the National Association of Corporate Directors (NACD), New York - Corporate governance ensures that long-term strategic objectives and plans are established and that the proper management structure (Organization, Systems, and People) is in place to achieve those objectives, while at the same time making sure that the structure functions to maintain the corporation's integrity, reputation, and responsibility to its various constituencies.

Example: Good Corporate Governance Starts at Scratch

Mr. Sanjeev Bikhchandani, Info Edge's founder and executive vice-chairman, made a statement that the framework of good corporate governance starts with

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the company's promoter/founder's mind. Because, the promoter's commitment in framework sustains the good corporate governance in spite of any oversight from board of directors, investors, audit committees or auditors in their corporate performances.

Source: https://economictimes.indiatimes.com/tech/startups/good-governance-begins-in-the-founders-head-info-edges-sanjeev-bikhchandani/articleshow/90909696.cms, dated: 18th April 2022, accessed on 24.08.22.

19.5 Difference between Corporate Governance and Corporate Management

Table 19.1 gives the differences between corporate governance and corporate management.

Table 19.1: Corporate Governance Versus Corporate Management

Corporate Governance	Corporate Management
1. Related to the entity's basic nature, objective, and truthfulness of the institution	1. A hands-on activity
2. Basic focus is on the importance, stability, and fiduciary aspects of the entity.	2. Basic focus is on achieving a specific objective over a period of time.
3. Involves monitoring and controlling the strategic direction, socio-economic and cultural framework, external factors, and stakeholders of the entity.	3. Involves implementing or managing the activities by making an optimum use of the existing resources in order to achieve the desired objectives.
4. External focus	4. Internal focus
5. Assumes an open system	5. Assumes a closed system
6. Strategy-oriented	6. Task-oriented
7. Concerned with where the company is going	7. Concerned with getting the company there

Example: Corporate Governance Supersedes Corporate Management

In July 2022, food delivery company 'Zomato' ESOP (Employee Stock Option Scheme) was opposed by 82% of its investors. In the same month, 72% of institutional investors opposed its logistics company 'Delhivery' ESOP scheme. In February 2022, 68% of institutional investors voted against their

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Indian digital payments and financial services company 'Paytm' ESOP scheme.

Here, the importance of corporate governance over corporate management was clearly visible. Though the management was for the ESOP scheme yet a large chunk of the investors voted against it. Because the management disclosures concerning the scheme failed in gaining investors' confidence for the scheme.

Source:https://economictimes.indiatimes.com/markets/stocks/news/fis-oppose-liberal-stock-options-pay-deals-for-top-execs-of-new-age-cos/articleshow/93697552.cms, dated: 22nd August 2022, accessed on 24.08.22

Check Your Progress - 1

1. Basic issues addressed by corporate governance are:
   i. Ethical issues
   ii. Competence issues
   iii. Efficiency issues
   iv. Accountability issues
   a. Only i, ii and iii
   b. Only i, ii and iv
   c. Only i, iii and iv
   d. Only ii, iii and iv
2. Which of the following is an unethical practice followed by the corporation underthe cover of public relation?
   a. Bribes
   b. Lobbying
   c. Giving gifts to potential customers
   d. Cartels formation
3. Which of the following issues are concerned with the problem of fraud?
   a. Ethical
   b. Competence
   c. Efficiency
   d. Accountability

4. Which of the following issues emerge out of the stakeholders' need for transparency of management in the conduct of business?

    a. Ethical

    b. Competence

    c. Efficiency

    d. Accountability

5. Which of the following issues raised due to the growing scale of corporations andtheir style of functioning should be addressed by corporate governance?

    i. The magnitude and complexity of corporate groups

    ii. The importance of institutional investors

    iii. The growth of public companies

    iv. Rise in hostile takeovers

    a. Only i, ii and iii

    b. Only i, ii and iv

    c. Only i, iii and iv

    d. Only ii, iii and iv

6. Which of the following issues must be addressed by corporate governance?

    i. Share trading

    ii. Litigations against directors

    iii. Need for restructuring of boards

    iv. Changes in auditing practices

    a. Only i, ii and iii

    b. Only i, ii and iv

    c. Only i, iii and iv

    d. Only ii, iii and iv

7. Corporate governance can be described as a system of structuring, operating andcontrolling a company with a view to achieve which of the following strategic goals?

    a. Short-term

    b. Annual

c. Medium-term

d. Long-term

8. Which of the following statements about corporate governance holds true?

   i. It leads to the building of a legal, commercial and institutional framework and demarcates the boundaries within which these functions are to be performed.

   ii. It ensures that short-term strategic objectives and plans are established and that the proper management structure is in place to achieve those objectives.

   iii. The structure functions to maintain the corporation's integrity, reputation and responsibility to its various constituencies.

   a. Only i and ii

   b. Only i and iii

   c. Only ii and iii

   d. i, ii and iii

19.6 Theories of Corporate Governance

The first theory of corporate governance, the theory of McGregor, was based on the assumption that human beings are by nature trustworthy and that they act in good faith with integrity and honesty. These beliefs are also reflected in the company law. The concept of corporate governance believed that monitoring is required only to curb the rare misconduct of employees. The stewardship theory proposed by Donaldson and Davis in 1988 was also based on the same beliefs. This theory also accepted the assumptions on which some behavioral theories like McGregor's Theory Y of human behavior were developed. According to Theory Y -

- The company's management has to organize resources like men, material, money, and machines in the best possible way to accomplish the corporate goals (profits, volumes, and quality products)
- Employees by nature are not averse to behaving in accordance with the company's requirements.
- Every employee has an in-built motivation to behave in a way that will help the company achieve its objectives.
- Berle and Means carried out studies on corporate governance that brought out some facts that contradicted and questioned the assumptions of the

stewardship theory in the then corporate scenario. Given here are some facts put out by them.

a. Divergent interests of the owners and management.
b. Separation of ownership from management.
c. The fact that there is no single shareholder who holds a major chunk of equitycapital.
d. The inability of small investors to directly monitor the activities of thecorporation in which they have invested.
e. Control over the company shifting from owners to the management.

Berle argued that when the owners' interests (share price, dividends) were different from that of the management (job security, remuneration, other benefits), the management would not show the kind of interest in optimum utilization of resources as the owners would. Thus, owners need a monitoring mechanism to ensure that the management's interests and the owners' interests are properly aligned.

Jensen and Meekling strengthened Berle's argument by staring that the relationship between the shareholders and the management was that of a principal and an agent, respectively. The relationship, called the agency theory, can be defined as a contract under which the principal (shareholders, in this case) appoints another person (management, in this case) to carry out some activities on their behalf (manage the company and attain the company's objectives). If the interests of both the agent and the principal conflict, then the agent may not always act in the best interests of the principal. He/she (they) may act in a way that would satisfy his/her (their) own interests. That is, the agent may not always take decisions that will benefit the principal.

The agency theory states that agents/managers/employees cannot be trusted to act in the best interests of the shareholders, and should be monitored and controlled to ensure that they follow the set policies, procedures, and plans of the organization. Jenson was of the view that companies should incur some costs to ensure management compliance. These costs are in the form of setting up monitoring mechanisms like boards, which require the appointment of outside independent directors to carry out checks like audits to evaluate the management's performance. These theories of corporate governance laid the basis for the future studies on the concept.

Example: Vicarious Liability 'in' Agency Theory

On 18th July 2022, the Bombay High Court held in a case that the company's non-executive and independent directors were not liable for the company's acts as they were not in charge and responsible for the day to day operations of the

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company. All those persons who were in charge and responsible for the company operations would be held responsible for any allegation that arose from such operations. Because it was the cardinal principle of criminal jurisprudence that where there were allegations of vicarious liability, there had to be sufficient evidence of the active role of each director, the Court said. This was the case of Meena Anand Suryadutt Bhatt v. Union of India, 2022, decided by the Bombay High Court on 8th July 2022.

Source: https://www.thehindubusinessline.com/news/independent-directors-not-liable-for-the-acts-of-the-company-bombay-hc/article65654246.ece, dated: 18th July 2022, accessed on 24th August 2022.

19.7 Models of Corporate Governance

The corporate governance models try to involve various stakeholders in the governance of the company. Given here are the Anglo American, German, Japanese, and Indian models of corporate governance.

19.6.1 Anglo American Model

In this model, shareholders elect the board of directors and take up an advisory role. Through the board, the shareholders control a private corporation. The board carriesout three functions on the shareholders' behalf -- representation, direction, and oversight. The board appoints and supervises the managers who take care of the organization's daily activities.

The employees, suppliers, and creditors are the company's stakeholders. The creditors have a lien on the company's assets. The boarddesigns the company's policy, which is implemented by the management. An information system is used by the board to monitor whether the policies are implemented or not. This model is most suitable for a manufacturing organization as it facilitates efficient monitoring of production, exchange, and performance.

19.6.2 German Model

In this model, though the shareholders own the company, they do not directly control the governance mechanism. The employees are allowed to participate in the governance mechanism. The employees are responsible for the policies that are to be implemented by them for attaining the organization's objectives (profit, market share, high volumes). The supervisory board, appointed jointly by the shareholders and the labor unions (employees), appoints and monitors the management board. The management board conducts the regular operations of the company, and reports to the supervisory board. The model allows the labor relations' officer to be on themanagement board. This ensures workers' participation in the governance mechanism.

19.6.3 Japanese Model

In this model, the financial institutions have a major say in the governance mechanism. The shareholders and the banks appoint the board members and the president. The president consults the board and their relationship is hierarchical in nature. The board usually ratifies the decisions taken by the president. Though the shareholders are the owners of the business, the financial institutions play a vital role as they finance the business. The board carries out the management function. Sometimes the financial institutions monitor the management function by nominating the managerial personnel. The banks even have the power to suspend the board in case of an emergency.

19.6.4 Indian Model

This model is a mix of the Anglo-American and German models. Indian companies can be grouped into three categories -- private companies, public companies, banks and other companies. The private companies are held by the founder, his/her family, and associates, who exercise maximum control over the company's activities. Thebusiness is financed by retained earnings or/and debt. The role of external equity finance is minimal. In public companies, the central and state governments choose the board members. The stakeholder's interests are given low priority, some public companies have been disinvested from, but the government continues to have a considerable hold over the company's activities. Large public companies are run to serve the government's interests rather than aiming for efficiency and maximizinglong-term owner value.

Example: Brazilian Model of Corporate Governance

In the corporate governance structure 2022, a new trend was put forth by Brazilian companies-

The companies were creating an advanced climate initiatives beyond its green washing and leadership accountability. Besides, they were also ensuring the shareholders' scrutiny got done over the adopted sustainable environmental objectives like to protect the forest sanctity in Amazon rainforest.

As the S of ESG (Environment Social and Governance) was gaining momentum to bring reforms into corporate sector, the shareholders shifted their focus upon current economic imbalance in the region to ensure that the board provided a healthy life for its employees, customers and stakeholders. The ensurance was in the form of pay equity, diversity, inclusion, education, etc.

Brazilian investors' interest upon the quality of board composition and diversity, led to the standardization of the director's professionalization,

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nomination process, tenure, independence, boarding, evaluation process, gender parity, etc.

Brazilian stewardship culture inclusion of risk oversight and better corporate governance in it, led to the board's review of the shareholders engagement plan and its process to prevent proxy fights. The ESG, board composition, risk oversight, disaster preparedness, etc. became a part of the plan.

In addition to above, the structure recommended stringent listing requirements, assessments and enforcement actions from regulatory perspective. All this was to provide a strong governance structure for the qualitative director's performance and board culture.

Source:https://www.europeanbusinessreview.com/global-trends-of-corporate-governance-in-2022/, dated: 1st April 2022, accessed on 25.08.22

Activity: In which model of corporate governance do the shareholders elect the board of directors? Discuss this model of corporate governance and the roles and responsibilities of the board members of such board?

Answer:

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Check Your Progress-2

9. Which of the following statements on corporate governance is true?
   i. It has an external focus
   ii. It assumes a closed system
   iii. It is strategy oriented
   iv. It is concerned with where the company is going

   a. Only i, ii and iii
   b. Only i, ii and iv
   c. Only i, iii and iv
   d. Only ii, iii and iv

10. Which of the following statements on corporate management is true?
    i. It has an internal focus
    ii. It assumes a closed system
    iii. It is strategy oriented

iv. It is concerned with getting the company there

a. Only i, ii and iii
b. Only i, ii and iv
c. Only i, iii and iv
d. Only ii, iii and iv

11. The corporate governance theory of McGregor was based on which of the following assumptions?

i. Humans by nature are trustworthy
ii. Humans are efficient
iii. Humans act in good faith
iv. Humans act with high in integrity and honesty

a. Only i, ii and iii
b. Only i, ii and iv
c. Only i, iii and iv
d. Only ii, iii and iv

12. Which of the following statements apply to McGregor's Theory Y?

i. The management of a corporation is responsible for organizing its resources in thebest possible way to accomplish the corporate goals
ii. Employees by nature are averse to behaving in accordance with the corporations' requirements
iii. Every employee has an in-built motivation to behave in a way that will help thecorporation to achieve its objectives

a. Only i and ii
b. Only i and iii
c. Only ii and iii
d. i, ii and iii

13. Which of the following facts contradict the assumptions of stewardship theory?

i. Separation of ownership from management
ii. There is no single shareholder who holds a major chunk of equity capital
iii. Control over the corporation changing from the management to the owners
iv. Divergent interests of the owners and management

a. Only i, ii and iii
b. Only i, ii and iv
c. Only i, iii and iv
d. Only ii, iii and iv

14. Which of the following statements about Anglo-American model of corporate governance are true?
    i. The shareholders do not elect the board of directors
    ii. Shareholders usually control a private corporation through the board of directors
    iii. The creditors have a lien on the assets of the corporation
    iv. Employees, suppliers and creditors are stakeholders in the corporation

    a. Only i, ii and iii
    b. Only i, ii and iv
    c. Only i, iii and iv
    d. Only ii, iii and iv
15. Which of the following statements about Anglo-American model of corporate governance is false?
    a. The Board of Directors designs the policy of the corporation, which is then implemented by the management.
    b. Using a well-designed information system, the board monitors the implementation of this policy in the organization.
    c. The Board appoints and supervises the officers (managers) who take care of the daily activities of the organization.
    d. The financial institutions have a major say in the governance mechanism.
16. Which model of corporate governance is most suitable for a manufacturing organization as it facilitates efficient monitoring of production, exchange and performance?
    a. Anglo American
    b. German
    c. Japanese
    d. Indian
17. Who selects the members in the supervisory board of the German model of corporate governance?
    i. Shareholders
    ii. Labor unions
    iii. Bankers

    a. Only i
    b. Only iii
    c. Only i and ii
    d. Only ii and iii
18. Which of the following statements about German model of corporate governance is false?
    a. Shareholders directly control the governance mechanism.

b. The members on the supervisory board are elected by the labor unions and the shareholders
c. Employees are not just stakeholders, but also have a say in the governance mechanism
d. Employees are responsible for the policies that are to be implemented by them for attaining the objectives of the organization

19.8 Evolution of Corporate Governance

Earlier, shareholders believed that stringent government controls would prevent malpractices of the companies. Later, after some instances where the government supported some companies for their own benefits cropped up, it was realized that the government was not always the best guardian of public interest. Shareholders felt the need for market-driven corporate governance that would be more democratic and flexible. This led to the origin of self-imposed corporate governance within the corporate system. The active participation of various stakeholders has strengthened the corporate governance mechanism and helped it to evolve beyond a set of static rules. Many factors contributed to the evolution of corporate governance. Given here are some of these factors.

- The responsibility for ensuring good corporate conduct shifted from government to a free-market economy.
- There was active participation of individual and institutional investors. There was increasing competition in the global economy.
- With the government relaxing direct and indirect administrative controls, alternative mechanisms became necessary to monitor the companies' performance in free markets. Shareholders believed that market forces could ensure self-imposed corporate conduct by way of rewarding success and punishing the failures of companies. Many free-market economies laid down effective regulations to monitor companies. However, regulations alone do not ensure good governance. To become effective, they must be enforceable by law.

The growth of global fund management business also boosted corporate governance. Institutional investors like insurance companies and pension and tax funds account for more than half the capital in US-based companies. This trend is also growing in India. Earlier institutional investors did not monitor the activities of the companies in which they invested. But competition in the fund management business has forced them to take an active role in governance in order to safeguard their investments in the companies. Many institutional investors express their views strongly with regard to various matters such as financial and operational performance, business strategy, and remuneration of top-level managers. Along with the non-executive directors, these institutional investors monitor the performance of companies.

Active investors demand good performance in the form of return on investment, and they also expect timely and accurate information regarding the company's performance. Institutional investors can exert pressure on the management as they own a considerable share in the capital, and any criticism from them can greatly impact the share prices. Investors believe that only strong corporate governance mechanisms and practices can save them from the ever-growing power of corporations, which can influence public policy to the detriment of investors.

Increasing competition in the global economy has compelled companies to perform better by going in for cost-cutting, corporate restructuring, mergers and acquisitions, and downsizing. All these activities can be carried out successfully only if there is proper corporate governance.

In India, the concept of corporate governance is still in its nascent stage. The recommendations of Kumar Mangalam Birla and the CII committee are the first steps in India toward ensuring better corporate governance. Prior to these, SEBI (Securities and Exchange Board of India) took various steps to strengthen corporate governance in India. Some of these steps are as follows.

- Reinforce the disclosure norms for IPOs (Initial Public Offerings) based on the recommendations made by the Malegam Committee set up by SEBI.
- Provide details about the utilization of funds, deviations (projected versus actual) in the utilization of funds in the directors' reports based on the requirements of the Companies Act. Also provide information about the cash flows and funds flow in the annual reports.
- Declare quarterly results.
- Appoint a compliance officer for monitoring the share transfer process and ensuring compliance with various rules and regulations.
- Disclose price and material sensitive information that have an impact on the company's performance
- Send a copy of the complete balance sheet to every household and abridged balance sheet to all shareholders.
- Issue rules regarding preferential allotment of shares at market prices.
- Issue regulations providing for a fair and transparent framework for takeovers andmajor acquisitions.

Post the Kumar Mangalam Committee, several other committees were constituted from time to time to bring in revisions and improvements in the corporate governance landscape. Some of the major committees among these include the Advisory Group on Corporate Governance constituted by the RBI, the Naresh Chandra Committee, N.R.Narayana Murthy Committee and the J.J Irani Committee.

Example: Covid Pandemic Shaped Corporate Governance

Covid-19 pandemic led to a trend in corporate governance practices in 2021. The trend appeared primarily in the quality of shareholder proposals, climate change accountability, and proxy rules.

In 2021, as a fight to protect against Covid 19, several companies successfully held its annual general meetings virtually. The meetings were conducted in a way as they were held in-person. In fact, the shareholders' participation and their proposals increased. The shareholders' participation significantly increased their focus upon the workforce diversity, political lobbying expenditures, emissions and environmental degradation. The shareholders' proposals increased over 60% when compared to that in 2020. This brought a change in the regulatory developments too.

In November 2021, the Securities and Exchange Commission (SEC) released rules for usage of 'Universal Proxy Cards' in contested director elections. The rules laid emphasis on both the companies and dissidents to mention all director nominees on their cards. This gave the complete details of director nominees to shareholders, significantly increasing the scope for split-ticket voting.

The outlook of courts redefined the enterprise risk management in 2021. The enterprise risk couldn't take the form of systemic social issues; worker recruitment, retention and safety; supply chain shortages; and climate change in specific. So, the companies should continuously oversee and display the risks involved in their operations and tailor them accordingly.

Source: https://www.jonesday.com/en/insights/2022/01/emerging-developments-in-corporate-governance, dated: January 2022, accessed on 26.08.22

Activity 1: Discuss the model of corporate governance in which the employees ofan organization play a major role in the selection of the board of directors.

Answer:

Check Your Progress-3

19. Which of the following statements about Japanese model of corporate governance is false?
    a. The financial institutions have a major say in the governance mechanism
    b. The shareholders, along with the banks, appoint the members on the board
    c. The president has the authority to make independent decision
    d. The banks have the power to suspend the board in case of an emergency
20. Who carries out the management function in the Japanese model of corporate governance?
    a. Board of directors
    b. President
    c. Supervisory board
    d. Shareholders
21. Under the Japanese model of corporate governance, the financial institutions monitor the management function by constituting which of the following?
    a. Appointing the supervisory board
    b. Ratifying and supervising president decision
    c. Holding stake in the company
    d. Nominating the managerial personnel
22. The Indian model of corporate governance is a mix of the
    i. Anglo-American model
    ii. German model
    iii. Japanese model
    a. Only i and ii
    b. Only i and iii
    c. Only ii and iii
    d. i, ii, and iii
23. Which of the following statements about Indian model of corporate governance are true?
    i. The founder, his family, and associates closely hold the private companies and they exercise maximum control over the activities of the company
    ii. The businesses of private companies are financed by retained earnings or/and debt

iii. Private companies are highly financed by external equity

a. Only i and ii

b. Only i and iii

c. Only ii and iii

d. i, ii, and iii

24. Which of the following statements about the public enterprise in India is false?

a. The central and state governments choose the members of the board.

b. The interests of the stakeholders are given the highest priority.

c. Large public sector enterprises are run to serve the interests of the government rather than aiming for efficiency and maximizing long-term owner value.

d. Even after the disinvestment of some public sector companies, the government continues to have a considerable hold over the activities of the company.

25. Shareholders realized that the government is not always the best guardian of public interest. This rouse the need for market driven corporate governance that would be more___and _______.

a. Autocratic, rigid

b. Autonomous, firm

c. Democratic, flexible

d. Authoritarian, rigid

26. Which of the following factors have contributed to the evolution of corporate governance?

i. The responsibility for ensuring good corporate conduct shifted from governmentto a free-market economy.

ii. Active participation of individual and institutional investors.

iii. Reduced competition in global economy.

a. Only i and ii

b. Only i and iii

c. Only ii and iii

d. i, ii, and iii

27. Which of the following is not a step taken by SEBI to strengthen corporate governance in India?

a. Strengthening of disclosure norms for Initial Public Offers

b. Inclusion of cash flow and funds flow statement in annual reports

c. Declaration of only the annual results

d. Providing information in directors' reports for utilization of funds and variation between projected and actual use of funds according to the requirements of the Companies Act

19.9 Summary

- Corporate governance practices are a set of structural arrangements that are emerging in free-market economies to align the management of companies with the interests of their shareholders (in particular) and other stakeholders, and society at large.
- Corporate governance addresses three basic issues -- ethical issues, efficiency issues, and accountability issues.
- Governance is concerned with the intrinsic nature, purpose, integrity, and identity of the institution, with a primary focus on the entity's relevance, continuity, and fiduciary aspects. Management is more of a hands-on activity. It primarily focuses on specific goal attainment over a definite time frame and in a prescribed organization.
- Some of the theories of corporate governance are the theory of McGregor, the stewardship theory proposed by Donaldson and Davis, the theories propounded by Berle and Means, and the theories brought forward by Jensen and Meckling.
- The corporate governance models try to involve various stakeholders in the governance of the company. These are the Anglo American, German, Japanese, and Indian models of corporate governance.
- Earlier, shareholders believed that stringent government controls would prevent malpractices of companies. Later, due to some instances where the government supported some companies for their own benefits, it was realized that government was not always the best guardian of public interest.
- Shareholders felt the need for market-driven corporate governance that would be more democratic and flexible.
- Market forces, active individual and institutional investor participation, and enhanced competition have helped corporate governance to evolve beyond a set of static rules.

19.10 Glossary

Corporate Governance: It is the system by which business corporations are directed and controlled. It specifies the distribution of rights and responsibilities among different participants in the corporation such as, the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs.

19.11 Self-Assessment Test

"Good corporate governance has to make sure that the organization structure functions to maintain the corporation's integrity, reputation and responsibility to its various constituencies." How do various organizations define the concept of corporate governance?

How does corporate governance align the management of the company with theinterests of shareholders and other stakeholders?

Discuss the model of corporate governance in which the employees of an organization play a major role in the selection of the board of directors.

Discuss the model of corporate governance in which financial institutions play amajor role.

What is the importance of corporate governance? What are the factors that contributed to the evolution of corporate governance?

What are the different theories of corporate governance? How does corporate governance differ from corporate management?

19.12 Suggested Readings / Reference Material

1. K P Muraleedharan, E K Satheesh (2022). Fernando's Business Ethics and Corporate Governance, Pearson India. 3rd edition
2. Manuel G. Velasquez (2021). Business Ethics – Concepts and Cases. Pearson Education, 8th edition
3. K Viyyanna Rao & G Naga Raju (2020). Business Ethics and Corporate Governance. 1st edition. Wiley
4. Jyotsna GB & RC Joshi (2020). Business Ethics and Corporate Governance. McGraw Hill India. 1st edition
5. Sandeep Goel (2020). Corporate Governance. McGraw Hill India. 1st edition

19.13 Answers to Check Your Progress Questions

1. (c) Only i, iii, and iv

Corporate governance addresses three basic issues: ethical issues; efficiency issues; and accountability issues. Ethical issues are concerned with the problem of fraud, which is becoming wide spread in capitalist economies. Efficiency issues are concerned with the performance of management and accountability issues emerge out of the stakeholders' need for transparency of management in the conduct of business.

2. **(b) Lobbying**

   Corporations often employ fraudulent means to achieve their goals such as maximizing long-term owner value. Bribes, gifts to potential customers, cartel formation and lobbying all are unethical means (practices) followed by the corporations but corporations cover up lobbying under public relation and are hence are not caught.

3. **(a) Ethical**

   Ethical issues are concerned with the problem of fraud.

4. **(d) Accountability**

   Accountability issues emerge out of the stakeholders' needs for transparency of management in the conduct of business.

5. **(b) Only i, ii, and iv**

   The emergence of private companies and the growing complexity of corporate groups is one of the main concerns of corporate governance. It is also concerned with the growing influence of institutional investors on the corporations, which create suspicion in the minds of minority investors. Issues concerning hostile takeovers, particularly management buy-outs, are also addressed by corporate governance.

6. **(d) Only ii, iii, and iv**

   The growing scale of corporations and their style of functioning have raised many new issues that must be addressed by corporate governance. Some of these issues are: Insider trading, litigations against directors, and need for restructuring of boards and changes in auditing practices.

7. **(d) Long-term**

   Corporate governance can be described as a system of structuring, operating and controlling a company with a view to achieve long-term strategic goals to satisfy shareholders, creditors, employees, customers and suppliers with the legal and regulatory requirements.

8. **(b) Only i and iii**

   Corporate Governance ensures that long-term strategic objectives and plans are established and that the proper management structure (Organization, Systems and People) is in place to achieve those objectives, the structure functions to maintain the corporation's integrity, reputation and responsibility to its various constituencies.

9. **(c) Only i, iii, and iv**

   Corporate governance has an external focus and assumes an open system. It is strategy-oriented and is concerned with where the company is going.

10. **(b) Only i, ii, and iv**

    Corporate management has an internal focus and assumes a closed system. It is task-oriented in nature and is concerned with reaching the desired objective or goal i.e. getting the company there.

11. **(c) Only i, iii, and iv**

    The first theory of corporate governance i.e. the Theory of McGregor was based on the assumptions that humans are by nature trustworthy and act in good faith, with high integrity and honesty. The corporate governance concept believed that monitoring is required only to curtail the rare misconduct of humans working in corporations. Efficiency of work force (humans) was not considered in the theory.

12. **(b) Only i and iii**

    According to McGregor's Theory Y: The management of a corporation is responsible for organizing its productive resources like men material, money and machines in the best possible way to accomplish the corporate goals (profits, volumes, quality products, etc.); Employees by nature are not averse to behaving in accordance with the corporations' requirements; And every employee has an in-built motivation to behave in a way that will help the corporation to achieve its objectives.

13. **(b) Only i, ii, and iv**

    Studies carried out by Berle and Means in 1932 in the field of corporate governance brought to light some facts that contradict the assumptions of stewardship theory. They are: separation of ownership from management; there is no single shareholder who holds a major chunk of equity capital; control over the corporation changing from the owners to the management; and divergent interests of the owners and management.

14. **(d) Only ii, iii and iv**

    In this model of corporate governance, shareholders elect the board of directors and take up the advisory role. Shareholders usually control a private corporation through the board of directors. Employees, suppliers and creditors are stakeholders in the corporation. The creditors have a lien on the assets of the corporation.

15. (d) The financial institutions have a major say in the governance mechanism

In the Japanese model of corporate governance, the financial institutions have a major say in the governance mechanism and not in the Anglo-American model.

16. (a) Anglo American

Anglo-American model is most suitable for a manufacturing organization as it facilitates efficient monitoring of production, exchange and performance.

17. (c) Only i and ii

The supervisory board in German model of corporate governance is appointed jointly by the shareholders and the labor union. Half of the members on the supervisory board are elected by the labor unions while the remaining are elected by the shareholders (owners).

18. (a) Shareholders directly control the governance mechanism

In the German model of corporate governance, even though the shareholders own the corporation, they do not directly control the governance mechanism. Half ofthe members on the supervisory board are elected by the labor unions while theremaining are elected by the shareholders (owners). The employees are not just stakeholders, but also have a say in the governance mechanism. Thus, employees become responsible for the policies that are to be implemented by them for attaining the objectives (profit, market share, high volumes …. etc.) of the organization.

19. (c) The president has the authority to make independent decision

In the Japanese model of corporate governance, the financial institutions have a major say in the governance mechanism. The shareholders, along with the banks, appoint the members on the board. The president consults the board and their relation is hierarchical in nature, he is not authorized to make independent decision. Usually the board ratifies whatever decisions the president takes. The financial institutions that finance the business have a crucial role in it even though the shareholders are the owners of the business. The banks even have the power to suspend the board in case of an emergency.

20. (a) Board of directors

In Japanese model of corporate governance, the board of directors (executive management) carries out the management function.

21. (d) Nominating the managerial personnel

In the Japanese model, the executive management (board of directors) carries out the management function. Sometimes, the financial institution monitors the management function by nominating the managerial personnel.

22. (a) Only i and ii

The Indian model of corporate governance is a mix of the Anglo-American and German models.

23. (a) Only i and ii

Corporations in India can be grouped into three categories: private companies, public companies, banks and other corporations. The founder, his family, and associates closely hold the private companies and they exercise maximum control over the activities of the company. The businesses of private companies are financed by retained earnings or/and debt. The role of external equity finance is minimal.

24. (b) The interests of the stakeholders are given the highest priority

In the case of public enterprises in India, the central and state governments choose the members of the board. Even after the disinvestment of some public sector companies, the government continues to have a considerable hold over the activities of the company. Here the interests of the stakeholders are given low priority. Large public sector enterprises are run to serve the interests of the government rather than aiming for efficiency and maximizing long-term owner value.

25. (c) Democratic, flexible

The growing realization by the shareholders that the government is not always the best guardian of public interest resulted in the need for a market driven corporate governance that would be more democratic and flexible.

26. (a) Only i and ii

Factors that have contributed to the evolution of corporate governance are: The responsibility for ensuring good corporate conduct shifted from government to a free-market economy; Active participation of individual and institutional investors; and the increasing competition in global economy.

27. (c) Declaration of only the annual results

SEBI has taken various steps to strengthen corporate governance in India. Some of these steps are: Strengthening of disclosure norms for Initial Public Offers; Providing information in directors' reports for utilization of funds and variation between projected and actual use of funds according to the requirements of the Companies Act; inclusion of cash flow and funds flow statement in annual reports; and Declaration of quarterly results.

Unit 20

Corporate Governance-Board Structures and Styles

Structure

"Corporate Governance should be done more through principles than rules."

- Adi Godrej, Indian billionaire businessman and industrialist

20.1 Introduction

The quote explains that the company board and its functioning is the replica of its corporate governance principles.

In the previous unit, we have discussed about corporate governance. In this unit, we shall discuss the various board structures and styles.

The structure and composition of a board plays a vital role in its effective functioning. Due to the increasing number of corporate frauds in India, and to enhance the functioning of the boards, stakeholders and regulatory authorities are considering changes in the composition of the boards. Some of these changes include limiting the term of the independent directors, making the independent directors accountable for the board's decisions, and separating the post of chief executive officer from that of the head of the board.

This unit will first discuss the various types of directors and their respective functions. We shall then move on to discuss the different types of board structures based on the type of directors on the board. We shall also discuss the issues that need to be addressed by organizations while designing a board structure. Finally, we shall discuss the various types of boards.

20.2 Objectives

By the end of this unit, you should be able to:

- Discuss the various types of directors and their respective functions.
- Explain the different types of board structures based on the type of directors on the board.
- Identify the issues to be addressed by organizations while designing a board structure.
- Explain the various types of boards classified based on their way of functioning, their commitment to effective decision making, and concern for interpersonal relations.

20.3 Types of Directors

Depending on their relationship with the organization's management. Directors can be categorized into executive directors, non-executive directors, nominee directors, representative directors, alternative directors, shadow directors, and associate directors. These are described in Table 20.1.

Table 20.1: Types of Directors and their Respective Functions

Directors	Functions
Executive Directors	• They perform a dual role as members of the board of directors and as executives in the organization. • They are appointed as directors by the shareholders and, according to company law, are responsible to the shareholders like any other type of director. • They are employees of the organization and are bound by an employment contract.
Non-executive Directors	• They do not hold an executive position in the organization onwhose board they work. • These directors are also known as outside directors. • They can be further divided into two categories – Independent Directors and Nominee Directors. • All pecuniary relationships or transactions of the non- executive directors should be disclosed in the annual report. *Contd. ....*

Nominee Directors	• They are appointed to the board of directors by major shareholders or financial institutions like banks and mutual funds. • They work to safeguard the interests of their principals (shareholders, banks, etc.). • Even though external stakeholders like banks appoint them, they, along with other directors, should act in the overall interests of the company.
Representative Directors	• They are similar to nominee directors. • They safeguard the interests of stakeholder groups like employees and customers, and also act in the overall interests of the company.
Alternative Directors	• They are appointed as per the Articles of Association to act as substitutes in the absence of an original director. • They enjoy all the powers of the directors they represent onthe board.
Shadow Directors	• They influence the decisions of the board without formallybeing present on the board. • When there is evidence to prove their influence, they can be held responsible for the acts of the company along with the directors of the board. • This type of directorship is seen in some family-owned companies.
Associate Directors	• These titles are given by some companies to managers as a token of appreciation or status symbol within the hierarchy of the organization.
Independent Directors	• According to the Kumar Mangalam Birla report, independent directors are directors who apart from receiving a remuneration do not have any other material pecuniary relationship or transactions with the company, its promoters, its management, or its subsidiaries, which in the judgment ofthe board, may affect their independence of judgment. • Independent directors are impartial and bring expertise to the board. They play an important role in resolving conflicts among shareholders and the company.
Women Director	It is mandatory to appoint a women director in the following classes of company: • Listed company; • Public unlisted company having paid-up share capital of one hundred crore rupees or more, or having a turnover of 300 crore or more

Example: Mr. Pratik Pota's appointment as an Executive Director

Eureka Forbes appointed Mr. Pratik Pota as its MD (Managing Director) and CEO (Chief Executive Officer). The appointment came into effect from 16th August 2022. The company said that he would lead the management team in scaling the business and strengthening the market position of Eureka Forbes'. He is expected to sustain the satisfaction of its growing customer base through its innovative products. On his appointment, Mr. Pota said that he would work with the management and passionate team members on the quality of product and service portfolio to meet the growing and varied health and hygiene needs of its customers.

Source:https://www.thehindubusinessline.com/companies/pratik-pota-to-lead-eureka-forbes-as-md-ceo/article65627244.ece; dated: 11th July, 2022, accessed on 01.08.2022.

Activity:

Match the following types of directors with their respective descriptions.

Director	Description
Nominee Directors	They safeguard the interests of stakeholder groups like employees and customers, and also act in the overall interests of the company.
Representative Directors	They influence the board without formally beingpresent on the board.
Shadow Director	They are appointed to the board of directors by external stakeholders such as banks and mutual funds, and act in the overall interest of the company.

Answer:

____

____

____

Check Your Progress-1

1. Which of the following statements about an executive director is false?
   a. He performs a dual role as a member of the board of directors and as an executivein the organization.
   b. He is appointed as a director by the financial institution.
   c. According to company law, he is responsible to the shareholders.
   d. He is an employee of the organization and is bond by an employment contract.

2. Who are the directors who apart from receiving director's remuneration do not have any other material pecuniary relationship or transactions with the company, its promoters, its management or its subsidiaries, which in the judgment of the board may affect their independence of judgment.
   a. Executive directors
   b. Non-executive directors
   c. Nominee directors
   d. Shadow directors
3. Which of the following statement/s about a nominee director is/are false?
   i. They are appointed to the board of directors by the major shareholders orfinancial institutions.
   ii. These directors work towards safeguarding the overall interests of the company.
   iii. They are appointed to act as a substitutes in the absence of an original director
   a. Only i
   b. Only iii
   c. Only i and ii
   d. Only ii and iii
4. Who safeguards the interests of stakeholder groups like employees, customers etc. and also act in the overall interests of the company?
   a. Associate directors
   b. Independent directors
   c. Shadow directors
   d. Representative directors
5. Who are appointed as per the Articles of Association to act assubstitutes in absence of an original director?
   a. Shadow directors
   b. Nominee directors
   c. Alternate directors
   d. Representative directors
6. Who are the directors who influence the decisions of the board without formally being present on the board?
   a. Shadow directors
   b. Nominee directors
   c. Associate directors
   d. Representative directors

7. What is a title given to managers by some company as atoken of appreciation or status symbol within the hierarchy of the organization?
   a. Shadow director
   b. Executive director
   c. Associate director
   d. Alternate director
8. Which of the following statements is false?
   a. Representative directors are appointed as per the Articles of Association to act assubstitutes in absence of an original director.
   b. An executive director is appointed as a director by the shareholders and,according to company law, is responsible to the shareholders.
   c. Nominee directors work towards safeguarding the interests of their principles i.e. external stakeholders like banks, financial institution, shareholders etc.
   d. Representative directors safeguards the interests of various stakeholder groupslike employees, customers etc.

20.4 Types of Board Structures

Depending on the type of directors on the board or their relation to the company, board structures can be of four types all-executive board, majority executive board, majority outside board, and two-tier supervisory board.

All-Executive Board

Every member on the all-executive board is also a member of the management. There are no outside directors. The managers' responsibilities are clearly spelt out in the employment contract and the labor law. These boards are mostly suitable for family-owned businesses and completely owned subsidiary companies, where there is no separation between the owner and the management. As all the executive directors represent the company's owners. Their interests are automatically safeguarded. In case of a wholly-owned subsidiary, the board functions as per the managerial policies and guidelines framed by the management.

The effectiveness of all-executive boards is questioned due to the direct involvement of the family in the management or due to the widely spread shareholdings. These boards suffer from a shortage of internal talent in the organization for supervising the company's governance. These problems lead to the need for non-executive or outside directors for better corporate governance.

Majority Executive Board

In majority executive boards, executive directors are in a majority while outside or non-executive directors are in a minority. The non-executive directors are appointed to the board to represent the interests of stakeholder groups like major shareholders, employees, and customers, and sometimes, to bring in the required expertise, knowledge, and experience to the company.

The non-executive directors act as a check on the powers of majority executive directors on the board. Ideally, there should be more than one non-executive directoron the board to influence the decisions of executive directors. Usually, one-third of the seats on the board are filled by non-executive directors. If necessary, they put considerable pressure on board decisions by way of resignations.

The majority executive board structure is criticized on the grounds that executive directors dominate the board, and may overlook some problems while evaluating their own performance. Sometimes, the board may become a battleground if each executive director starts arguing for more resources for his/her own department.

The Majority Outside Board

This board has a majority of non-executive directors, and is common in companies that are quoted on the New York Stock Exchange. Most of these directors represent stakeholder groups like major stockholders, customers, supplier or creditors (banks), and other financial institutions. The effectiveness and independence of such directors is questionable as they are somehow related to the company and represent a vested interest in the company, directly or indirectly. Many regulatory agencies are making it mandatory for companies to have independent directors on the committees appointed by the board. Attempts are being made to ensure the independent assessment of the board's/ management decisions.

Example: PFS Board – An Example for 'The Majority Outside Board'

Companies Act 2013 accommodates the board to have more number of outside directors. One such example was given below. Power Trading Corporation was owned by PSUs Power Grid, Power Finance Corporation, NTPC and NHPC.

As on 01.08.2022, the Board of Directors (Board) of PFS (PTC India Financial Services Limited) comprised:

Dr. Pawan Singh - Managing Director and Chief Executive Officer
Dr. Rajib Kumar Mishra – Nominee Director
Mr.Pankaj Goel – Nominee Director
Mrs. Sushama Nath – Independent Director
Mr.Ramesh Narain Misra – Independent Director
Mr.Jayanth Purshottam Gokhale – Independent Director
Mr.Devendra Swaroop Saksena – Independent Director

Source: https://www.ptcfinancial.com/cms/showpage/page/board-of-directors; Dated: Homepage, 2022, accessed on 01.08.2022

20.4.1 Two-tier Supervisory Board

This board has two separate boards the non-executive supervisory board and the executive management board. The supervisory board is empowered with monitoring the plans and performances of the executive board and appointing/firing the CEO.

20.4.2 Advisory Boards

These are used by large multinational companies that carry out business in many countries. The parent company selects a few experienced employees or others from foreign countries to advise them on issues pertaining to the business environment in these countries. These boards do not have any executive powers.

Activity: Answer the following questions --

a. SPK Limited, a large management consulting firms, has two boards. One of the boards is responsible for monitoring the plans and performances of the executive board, while the other one is empowered with appointing/ firing the chief executive officer of the company. What type of a board structure does SPK Limited have? What are the two types of boards called?

Answer:

b. Chetan and Company is a family-owned textile manufacturing company. The company is controlled by Chetan and his three brothers. All the brothers have equal interests in the company, and they are the owners of the company. According to you, what type of board structure would be suitable for a company like Chetan and Company? Why?

Answer:

Check Your Progress-2

9. In which type of board every member on the board is also a member of the management?
   a. All executive
   b. Majority executive
   c. Majority outside
   d. Two-tier supervisory

10. Which of the following board is a common feature in family owned businesses or in completely owned subsidiary companies?
    a. All executive board
    b. Majority executive board
    c. Majority outside board
    d. Two-tier supervisory board

11. The performance of all-executive board suffers when there is a ________________ of talent ____to the organization for overseeing the governance of the company.
    a. Pool, external
    b. Pool, internal
    c. Shortage, external
    d. Shortage, internal

12. In a majority executive board, non-executive directors are appointed to the board to:
    i. Represent the interest of board of directors
    ii. Bring in expertise, knowledge and experience
    iii. Keep a check on the powers of the executive director
    a. Only i and ii
    b. Only i and iii
    c. Only ii and iii
    d. i, ii and iii

13. In a majority executive board, it is conventional to have____________of the seats on the board to be filled by non-executive director, so that they can put considerable pressure on the board.
    a. Only one
    b. One-third
    c. Half
    d. Two-third

14. Which of the following statements about majority outside board is false?
    a. This board has a majority of outside, executive directors.
    b. This type of board structure is common in companies that are quoted on the New York stock exchange.
    c. Many regulatory agencies are making it mandatory for companies to haveindependent directors on the committees appointed by the board.
    d. None of the above

15. Which of the following boards represents the boards in the two-tier supervisory board?
    i. Executive supervisory board
    ii. Non-executive supervisory board
    iii. Executive management board
    iv. Non-executive management board
    a. Only i and ii
    b. Only i and iv
    c. Only ii and iii
    d. Only iii and iv
16. Which of the following statements about supervisory board is true?
    i. It monitors the plans and performances of the executive board
    ii. It is empowered to appoint the chief executive officer
    iii. It is not authorized to fire the executive officer
    a. Only i and ii
    b. Only ii and iii
    c. Only i and iii
    d. i., ii and iii
17. Large multinational companies take the help of_____________boards to ensurebetter governance.
    a. All-executive
    b. Majority outside
    c. Supervisory
    d. Advisory

20.5 Issues in Designing a Board

Organizations should address issues like the board size, role of the Chairman and the Chief Executive, and duality in the subsidiary company board, while designing a board structure.

Example: ONGC Top Post Recruitment - A Challenge for Recruiter

Oil and Natural Gas Corporation (ONGC) - India's top oil and gas producer and a public enterprise company, faced crisis management on completion of Mr.Shashi Shankar's tenure as its chairman and managing director. The tenure completed on 31st March 2021 and since then the government head hunter (PESB – Public Enterprise Selection Board) was unable to find any suitable candidate for this top job.

Contd. ....

Because, energy was vital for any nation and ONGC plays a vital role in India. Thus, it became a time consuming factor for PESB to recommend, and a specially designed 'sui generis' job description was what needed to attract the best talent available for this ONGC's top job. The appointed need to have an outstanding workable skills to scale the ONGC's activities significantly and rapidly.

In fact, on 19th June 2022, the government also sent a proposal wherein it proposed to extend the age limit up to sixty years (as on 1st April 2021) for considering an eligible candidate for this Board level position at ONGC.

Dr. Alka Mittal Director HR has additional charge of Chairman and MD as on August 2022.

Sources: (i) https://economictimes.indiatimes.com/industry/energy/oil-gas/oil-ministry-proposes-higher-age-limit-shorter-tenure-for-ongc-chairman/articleshow/92320262.cms?utm_ source=contentofinterest&utm _medium =text&utm_campaign=cppst; 19th June 2022, accessed on 03.08.2022.

(ii) https://ongcindia.com/web/eng/about-ongc/board-of-directors#:~:text=Director%20(HR)% 20and%20Chairman%20%26,Gas%20Corporation%20Limited%20on%2027.11.Dated: Homepage, accessed on 03.08.22.

20.5.1 The Board Size

The Articles of Association lay down the limit for the number of directors to be present on a company's board. The members can change this limit by passing a special resolution. Some boards may have only two directors while others may have twenty or more. The board's size generally depends on the company's size. The largerthe company, the larger will be the size of the board. The size of the board has a direct impact on its group dynamics. It is difficult to maintain interpersonal relations in boards that have more than seven or eight members. Due to differences in beliefs/opinions, members may form opposing groups in large boards. Having smaller boards will, however, leave the company with less experience, knowledge, and expertise to fall back on during times of crisis.

Section 149 of the Companies Act states that every company's board of directors must necessarily have a minimum of three directors if it is a public company, two directors if it is a private company and one director in a one person company.

Role of the Chairman and the Chief Executive

Stakeholders and other regulatory bodies have called upon companies to separate the roles of CEO and Chairman. This, according to them would curtail the CEO's dominance and ensure a power balance on the board. However, considering the current competitive environment, many companies are of the view that a single person should play both roles.

20.5.2 Subsidiary Company Boards

At times, a parent company's executive directors become non-executive directors on a Subsidiary's board.This may lead to clashes between both the classes as they feel that the subsidiary is being used as a cash cow to finance the needs of the other subsidiaries of the group. Also, the subsidiary's board effectiveness in inquiring about the parent company's policies is doubted as the performance measurement and the career prospects of the executive directors on the subsidiary board lies in the hands of the managers in the head office.

20.6 Styles of Functioning of Boards

Depending on their way of functioning, their commitment to effective decision making, and concern for interpersonal relations, the various types of boards are - rubber stamp boards, representative boards, country club boards, and professional boards. These are described in Table 20.2. To succeed in today's competitive world, most organizations are going in for a more professional style of functioning.

Table 20.2: Types of Boards and their Respective Functions

Boards	Functions
Rubber Stamp Boards	These usually endorse or ratify the CEO's decisions, and give little importance to good interpersonal relations or effective decision making. Wholly-owned subsidiaries have such boards as they merely exist to fulfill the norms laid down by the company law. The business is managed through the divisional organization structure.
Representative Boards	These give high priority to effective decision making and little or no priority to good interpersonal relations among board members.
Country Club Boards	These emphasize maintenance of cordial interpersonal relations, while concern for effective decision making takes a back seat.
Professional Boards	The representative interests of various directors on the board hamper cordial relations. Professional boards function in a style that gives high importance to both interpersonal relations and effective decision making.

Example: Board Functioning vis-à-vis Changed Environment

In the post Covid pandemic era, the company boards (Board of Directors) were facing several hurdles while performing their functions. The hurdles were like facing resistance from employees to resume office, bottlenecks in supply chain management, inflation, worldwide economic slowdown, cyber-attacks and its rising risks, unpredictable business climate, and changing regulatory aspects. This compelled for the periodic assessment of board agenda priorities; and its related structures, processes and controls, to ensure that the board was well-informed on a timely basis of matters requiring attention. The compelling move changed the functioning style of the board concerning its -

Contd. ....

- Risk and Strategy.
- Corporate goals and its ESG (environmental, social, and governance).
- Human capital and work atmosphere.
- Shareholders' participation.
- Crisis management.
- Board culture

Source: https://corpgov.law.harvard.edu/2022/01/05/board-oversight-key-focus-areas-for-2022/, dated: 5th January, 2022, accessed on 01.08.2022.

Activity: GKL is an India-based computer component manufacturing company that has a presence in about 12 countries throughout the world. The company follows a divisional organizational structure. All the decisions are taken by the chief executive officer of the company, and these are ratified by the company's board of directors. What are these boards called? How are they different from representative boards?

Answer:

____

____

____

____

____

Check Your Progress-3

18. Issues that a corporation should address while designing a board structure are:
    i. The Board size
    ii. The role of the manager
    iii. Duality in subsidiary company board
    a. Only i and ii
    b. Only ii and iii
    c. Only i and iii
    d. i., ii and iii
19. Which of the following statements is false?
    a. By passing a special resolution the board members can change the number ofdirectors to be present on the board.
    b. The size of the board has an inverse impact on the group dynamics of the board.
    c. The size of the board generally depends on the size of the company.
    d. None of the above

20. Stakeholders and other regulatory bodies frequently ask corporations to separate the roles of the_______________and the_________.
    a. Manager, executive
    b. CEO, chairman
    c. Chairman, executive
    d. CEO, manager
21. Depending on the way boards function, their commitment to effective decision- making and concern for interpersonal relations, they may be categorized as:
    i. Rubber stamp boards
    ii. Nominee boards
    iii. Country club boards
    iv. Professional boards
    a. Only i, ii and iii
    b. Only i, ii and iv
    c. Only i, iii and iv
    d. Only ii, iii and iv
22. Which of the following gives little importance to either good interpersonal relations or effective decision-making?
    a. Rubber stamp boards
    b. Representative boards
    c. Country club boards
    d. Professional boards
23. Which of the following board styles is followed by a wholly owned subsidiary whose boards exist merely to fulfill the norms laid down by company law?
    a. Rubber stamp boards
    b. Representative boards
    c. Country club boards
    d. Professional boards
24. A wholly owned subsidiary having a rubber stamp board is managed through a _______organizational structure.
    a. Simple
    b. Functional
    c. Divisional
    d. Matrix
25. Which of the following lays emphasis on maintaining cordial interpersonal relations, while concern for effective decision-making takes a back seat?
    a. Rubber stamp boards
    b. Representative boards

c. Country club boards
d. Professional boards

26. Which of the following accords high priority to effective decision-making and less or no priority to encouraging good interpersonal relations among board members?
    a. Rubber stamp boards
    b. Representative boards
    c. Country club boards
    d. Professional boards
27. Which of the following functions in a style that gives high importance to both interpersonal relations and effective decision-making?
    a. Rubber stamp boards
    b. Representative boards
    c. Country club boards
    d. Professional boards

20.7 Summary

- Depending on their relationship with the organization's management, directors can be categorized into executive directors, non-executive directors, nominee directors, representative directors, alternative directors, shadow directors, and associate directors.
- Depending on the type of directors on the board or their relationship with the company, board structures can be of four types all-executive board, majority executive board, majority outside board, and two-tier supervisory board.
- Organizations should address issues like the board size, role of the Chairman and Chief Executive, and duality in a subsidiary company board while designing the board structure.
- Depending on their way of functioning, their commitment to effective decision making, and concern for interpersonal relations, the various types of boards are rubber stamp boards, representative boards, country club boards, and professional boards.

20.8 Glossary

Independent directors: These are directors who apart from receiving a director's remuneration do not have any other material pecuniary relationship or transactions with the company, its promoters, its management, or its subsidiaries, which in the judgment of the board, may affect their independence of judgment.

20.9 Self-Assessment Test

1. Directors can be categorized based on their relationship with the management of the organization. What are the various categories of directors?
2. The structure and composition of a board plays a vital role in its effective functioning. What are the different types of board structures that can be formed in an organization?
3. Certain criteria should be kept in mind while designing a board structure. Explain these criteria.
4. Boards can be categorized based on their way of functioning, their commitment to effective decision making, and concern for interpersonal relations. List out and explain the types of boards.

20.10 Suggested Readings/Reference Material

1. K P Muraleedharan, E K Satheesh (2022). Fernando's Business Ethics and Corporate Governance, Pearson India. 3rd edition
2. Manuel G. Velasquez (2021). Business Ethics – Concepts and Cases. Pearson Education, 8th edition
3. K Viyyanna Rao & G Naga Raju (2020). Business Ethics and Corporate Governance. 1st edition. Wiley
4. Jyotsna GB & RC Joshi (2020). Business Ethics and Corporate Governance. McGraw Hill India. 1st edition
5. Sandeep Goel (2020). Corporate Governance. McGraw Hill India. 1st edition

20.11 Answers to Check Your Progress Questions

1. (b) He is appointed as a director by the financial institution.

The executive director performs a dual role as a member of the board of directors and as an executive in the organization. He is appointed as a director by the shareholders and, according to company law, is responsible to the shareholders like any other type of director. As an executive, he is an employee of the organization and is bond by an employment contract.

2. (b) Non-executive directors

Non-executive directors are directors who apart from receiving director’s do not have any other material pecuniary relationship ortransactions with the company, its promoters, its management or its subsidiaries, which in the judgment of the board may affect their independence of judgment. Further, all pecuniary relationships or transactions of the directors should be disclosed in the annual report.

3. (d) **Only ii and iii**

Nominee directors are those who are appointed to the board of directors by the major shareholders or financial institutions like banks, mutual funds etc. These directors work towards safeguarding the interests of their principles (shareholders, banks etc.). Alternate directors are appointed to act as substitutes in absence of an original director and not a nominee director.

4. (d) **Representative directors**

Representative directors safeguard the interests of stakeholder groups like employees, customers etc. and also act in the overall interests of the company.

5. (c) **Alternate directors**

Alternate directors are appointed as per the Articles of Association to act as substitutes in absence of an original director.

6. (a) **Shadow directors**

Shadow directors are those directors who influence the decisions of the board without formally being present on the board.

7. (c) **Associate director**

An associate director is a title given to managers by some company as a token of appreciation or status symbol within the hierarchy of the organization.

8. (a) **Representative director are appointed as per the Articles of associationto act as substitutes in absence of an original director**

Alternate directors are appointed as per the Articles of Association to act as substitutes in absence of an original director.

9. (a) **All-executive**

An all-executive board does not have even one outside director i.e. every member on the board is also a member of the management.

10. (a) **All-executive board**

All-executive boards are a common feature in many families owned businesses and completely owned subsidiary companies.

11. (d) **Shortage, internal**

An all-executive board does not have even one outside director i.e. every member on the board is also a member of the management. Therefore, the performance of this type of board suffers when there is a shortage of talent internal to the organization for overseeing the governance of the company.

12. (c) Only ii and iii

In a majority executive board, the non-executive directors are appointed to the board to represent the interests of stakeholder groups like major shareholder’s employees, customers etc. At times organizations appoint non-executive directors on the board to bring in the required expertise, knowledge and experience. The non-executive directors also act as a check on the powers of the majority executive directors on the board.

13. (b) One-third

Ideally, there should be more than one non-executive director on the majority executive board to influence the decisions of the executive directors. But it is conventional to have one-third of the seats on the board filled by non-executive directors, so that they can put considerable pressure on board decisions also by way of resignation if necessary.

14. (a) This board has a majority of outside, executive directors.

The majority outside board has a majority of outside, non-executive directors. This type of board structure is common in companies that are quoted on the New York stock exchange. Many regulatory agencies are making it mandatory for companies to have independent directors on the committees appointed by the board.

15. (c) Only ii and iii

The two-tier supervisory board structure has two separate boards: the non-executive supervisory board and the executive management board.

16. (a) Only i and ii

The supervisory board monitors the plans and performances of the executive board. This supervisory board is also empowered to appoint the chief executive officer and, if necessary even fire him.

17. (d) Advisory

Large multinational companies take the help of advisory boards to ensure better governance.

18. (c) Only i and iii

Issues that a corporation should address while designing a board structure are: the board size; the role of the chairman and the chief executive; and duality in subsidiary company board.

19. (b) The size of the board has an inverse impact on the group dynamics of theboard

The size of the board has a direct impact on the group dynamics of the board. Boards with more than seven or eight members may have problems in maintaining interpersonal relations. The size of the board generally depends on the size of the company, larger the company, larger the size of the board.

20. (b) CEO, chairman

Stakeholders and other regulatory bodies frequently ask corporations to separate the roles of the CEO and the chairman. They see this as a prerequisite to curtail the dominance of the CEO and to ensure balance of power on the board.

21. (c) Only i, iii, and iv

Depending on the way boards function, their commitment to effective decision-making and concern for interpersonal relations, they may be categorized as: rubber stamp boards; representative boards; country club boards; and professional boards.

22. (a) Rubber stamp boards

The rubber stamp board gives little importance to either good interpersonal relations or effective decision-making.

23. (a) Rubber stamp boards

Wholly owned subsidiaries, whose boards exist merely to fulfill the norms laid down by company law, have rubber stamp boards. This board usually endorses or ratifies whatever decisions the CEO takes.

24. (c) Divisional

Wholly owned subsidiaries, whose boards exist merely to fulfill the norms laid down by company law, have rubber stamp boards. Here the business is managed through the divisional organizational structure.

25. (c) Country club boards

The country club board lays emphasis on maintaining cordial interpersonal relations, while concern for effective decision-making takes a back seat.

26. (b) Representative boards

The representative board accords high priority to effective decision-making and less or no priority to encouraging good interpersonal relations among board members.

27. (d) Professional boards

Professional boards function in a style that gives high importance to both interpersonal relations and effective decision-making.

Unit 21
Corporate Governance - Roles and Responsibilities of Directors

Structure

"True leadership is the essence of good corporate governance."

- Dr.Sandeep Tare, Doctorate in Strategic Management and Entrepreneur

21.1 Introduction

Leadership can be either in the board of directors, directors, chairman, managing director, CEO or like of the company, renders good corporate governance if presented ethically and lawfully. Unit 21 explains the same.

In the previous unit, we have discussed the board structures and styles. In this unit, we shall discuss the roles and responsibilities of directors.

The board of directors (board) is responsible for ensuring good corporate governance. This involves a set of relationships between the management of a corporation, its board, and its stakeholders. The board must agree on the corporation's purpose (what it is for), its values (what it stands for), and the strategy to be adopted to achieve its purpose. Good corporate governance requires that the board must govern the corporation with honesty and enterprise in a manner which confirms and enhances the authority with which it has to function. This authority is not only regulatory but embraces the corporation's interaction with its stakeholders. Stakeholders' interests are affected by the way the board handles issues related to business ethics and environment protection. This in turn may influence the organization's reputation and long-term interests.

This unit will first discuss the roles, responsibilities, and duties of directors. We shall then move on to discuss the role and functions of the Chairman and the Chief Executive Officer. We shall also discuss the functions of the board. Finally, we shall discuss about the committees of the board.

21.2 Objectives

By the end of this unit, you should be able to:

- Discuss the roles, responsibilities, and duties of directors.
- Identify the role and functions of the Chairman.
- Recognize the role and functions of the Chief Executive Office.
- Explain the functions of the board.
- Discuss the committees of the board.

21.3 Role of Directors

A director assumes two roles -- performance role and conformance role -- while governing the activities of an organization.

21.3.1 Performance Role

In the performance role, the director carries out various activities that are aimed at enhancing the organization's overall performance. First, the director acts as a source of expertise and external information. Second, he/she caters to the organizational needs for networking, representing, and enhancing status. A director brings in the knowledge and experience required to solve the problems faced by the board. Outside directors, appointed by the organizations on their boards, usually act as specialists, who provide their expertise, knowledge, and skills to various areas such as finance, marketing, law, and engineering. They act as the eye of the board to the external world. They bring in information related to international markets, the financial environment, technological environment, etc., which are not readily accessible to the organization. Outside directors are generally handpicked from influential groups in the society. Organizations use them to gain access to these groups. The directors represent the company on public forums or committees. They act with the media on behalf of the organization. Outside directors, who are renowned in various fields, enhance the board's status, reputation, and credibility, and also boost customer/shareholder confidence in the company.

Example: Tata's Air India CEO and MD – Mr. Campbell Wilson

On 12th May 2022, Tata's Air India designated Mr. Campbell Wilson's as its CEO (chief executive director) and MD (managing director). Indian government gave security clearance to it on 26th July 2022. He was an aviation industry veteran having over 26 years of experience. He started his career as a management trainee with Singapore airlines. Prior to this appointment, he was the CEO of Singapore Airlines (a joint venture of Tata Group in full service carrier Vistara).

As Air India CEO designate, he visited several offices of Air India and had met many of its staff members. Talking about the performance, he stated that it's a long journey, to make Air India a world-class airline. He said "We should strive to overcome every issue, however minute it may be, to reach our destined journey ".

Source: https://economictimes.indiatimes.com/industry/transportation/airlines-/-aviation/air-india-ceo-designate-campbell-wilson-gets-security-clearance-from-home-ministry/articleshow/93134137.cms; dated: 26th July, 2022; accessed on 04.08.2022

21.3.2 Conformance Role

In the conformance role, the director should ensure that the company follows the policies and procedures laid down by the board by questioning and supervising the executive management. The conformance role is very tricky as it involves monitoring and evaluating own performance (in case of majority/all-executive boards). Independent, outside directors will be able to analyze issues that are brought to the Board's notice from a perspective different from that of the executive directors. This independent evolution of the top management's performance helps overcome the danger of adopting the executive board's narrow vision.

21.4 Responsibilities of Directors

The company law lays down the duties and responsibilities of the board. Though the directors' responsibilities vary from country to country, there are some that are common to the directors worldwide. These are responsibilities to shareholders and the obligation to maintain honesty and integrity.

The directors are responsible and accountable to the shareholders as they are appointed by them. They should be honest in their dealings with the shareholders and take decisions that will benefit the entire organization. Directors provide a strategic direction to the company by setting appropriate policies and monitoring the management's performance. All the shareholders must be given adequate and accurate information regarding every issue that could affect their interests. They should be given duly audited reports and accounts on a regular basis.

Example: Responsible Intent behind Mr.Shailesh's Resignation

On 22nd April 2022, Mr.Shailesh Haribhakti, had resigned as the chairperson and independent director of FLFL (Future Lifestyle Fashions Limited part of Kishore Biyani led Future Group) with immediate effect (i.e. from 22nd April 2022). He stated that he was resigning due to the volatility, complexity and unpredictable legal and financial circumstances that steered the company into unfavourable turns. Though several recommendations were made by FLFL Board (Board of Directors) from different parameters yet it failed to derive an operational solution for the company and its stakeholders.

Thus, as a responsible personnel of the Board, he tendered his resignation thereby enabling the company to find a better person for the company and its stakeholder's betterment.

Source:https://www.business-standard.com/article/companies/future-lifestyle-fashions-chairperson-shailesh-haribhakti-resigns-122042300708_1.html; dated: 23rd April, 2022, accessed on 09.08.2022.

Check Your Progress-1

1. Good corporate governance requires that the board must govern the corporation with__ and________ in a manner, which confirms and enhances the authority with which it has to function.
   a. Honesty, enterprise
   b. Efficiency, integrity
   c. Honesty, integrity
   d. Efficiency, enterprise
2. The way in which the board handles issues related to business ethics to environment protection may affect the interest of stakeholders and this in turn may have an influence on the reputation and ------------ interests of the business enterprise.
   a. Immediate
   b. Short-term
   c. Mid-term
   d. Long-term
3. Which of the following roles does a director assumes while governing the activities of an organization?
   i. Occurrence role
   ii. Performance role
   iii. Conformance role

a. Only i and ii
b. Only i and iii
c. Only ii and iii
d. i, ii, and iii

4. In which of the following roles does the director perform various activities that are aimed at improving the overall performance of the corporation?
   a. Conformance
   b. Performance
   c. Leader
   d. Executive
5. Various activities that a director performs in the performance role to improve the overall performance of the corporation are:
   i. He acts as a source of expertise and external information
   ii. He caters to the needs of the corporation for networking, representing, andenhancing status
   iii. He questions and supervise the executive management
   a. Only i and ii
   b. Only i and iii
   c. Only ii and iii
   d. i, ii, and iii
6. Which of the following is not a benefit of an outside director?
   a. They usually act as specialists, who provide their expertise, knowledge, and skills to various areas such as finance, marketing, law, and engineering
   b. They bring in information related to national markets, the financial or technological environment etc., which are readily accessible to the corporation
   c. They represent the company on public forums or committees and also act with the media on behalf of the corporation
   d. As they are renowned in a particular field, their presence enhances the status, reputation and credibility of the board
7. In which of the following roles is the director concerned with ensuring that the company follows the policies and procedures laid down by the board?
   a. Conformance
   b. Performance
   c. Leader
   d. Executive

21.5 Legal Aspects and Liabilities of Directors

As per the Companies Act, 2013, the Directors have three forms of liability:

Liability for Breach of Fiduciary Duty: An independent director, being in the fiduciary position of a trustee for the company, may incur liability for breach of his/her fiduciary duty to the company. (Schedule IV of the Companies Act, 2013).

Personal liability of a Director

- For ultra vires acts
- For mala fide acts
- For negligence

Liability to the third parties

Directors are criminally liable in pursuance of the different sections of the Companies Act, 2013

According to the Companies Act, directors are liable for the following.

21.5.1 Duties of Directors

Following are some of the important duties of directors.

- To exercise care in the discharge of functions as directors.
- To attend board meetings, and devote sufficient time and attention to the affairs of the company.
- To not be negligent, and not commit or let others commit tort-liable acts such as fraud, defamation, and invasion of privacy.
- To act in the best interests of the company, stockholders, and customers. To not misuse power.
- To protect the interests of creditors. To maintain confidentiality.
- To not make secret profits and make good any loss, if accrued due to breach of duty or negligence.
- To not exercise powers for a collateral purpose. To not waste company assets.

Example: Director's Duty – A Diligent Performance

On 19th January 2022, the independent directors on PFS (PTC India Financial Services) Board, Kamlesh Shivji Vikamsey, Santosh B Nayar and Thomas Mathew T (Board of directors), resigned from the Board with immediate effect. In their resignation letter they stated that certain corporate governance issues were not dealt by the Board prudently, thereby violated the Companies Act 2013 provisions. Their concerns were ignored by the Board and thus they resigned enmasse to avoid duty breach.

Contd. .....

Here, the resignation to prevent duty breach need not be the only remedy. In PFS, the majority of directors on the Board were independent directors, and thus multiple options will be with them to fulfil their duties -
Would have raised the corporate governance issues in an open letter to SEBI (Securities and Exchange Board of India), Regulator.
Would have asked the chairman cum managing director (key managerial personnel) to resign from the Board or to go on a long leave.
Would have done suo moto forensic audit.
Would have worked upon internal sources to pressurize the management.

Sources: (i) https://economictimes.indiatimes.com/small-biz/legal/strengthening-the-role-of-independent-directors-in-a-company/articleshow/90455204.cms; dated: 26th March, 2022; accessed on 09.08.2022
(ii)https://timesofindia.indiatimes.com/all-3-independent-directors-of-ptc-india-financial-services-resign/articleshow/89003564.cms; dated:19th January, 2022, accessed on 09.08.22.

21.6 The Role of the Chairman

The Chairman should manage the board and ensure that its policies are put into practice by the management. He/she has to work closely with the company secretaryto address legal issues. He/she should have a good understanding of the company's financial position and has to strictly watch the company's actual performance. He/she should have a clear idea of where the company stands and where it is headed.

The Chairman should also have clear understanding of the way in which a company is managed. He/she must identify weaknesses and see that the board discusses them. He/she should play a proactive role and be in a position to identify a problem. Through this, the Chairman can help the CEO take corrective action before things go out of control. The Chairman also plays a vital role in maintaining good relations between the board and the company's stakeholders. While doing this, he/she ensures that the board makes decisions that are in keeping with the stakeholder's interests.

The Chairman has to ensure that the internal needs of the board are met and that the board members are observing the code of conduct. He/she has to handle people from varied fields who serve the board. A Chairman must have good interpersonal relations. For effective functioning of the board, a Chairman should forge good relationships with the CEO, executive directors, and non-executive directors.

Example: Mr. Chandrasekaran Role as Tata Sons Chairman

On 11th February 2022, Tata Sons Board (Board of Directors) had reappointed Mr. Chandrasekaran as its chairman for the second term of five years. In the meeting, the Board reviewed his last five years of performance as chairman

Contd. ....

and on a satisfactory note considered his reappointment as its executive chairman. He also chaired its flagship operating companies like Tata Consulting Services, Tata Steel, Tata Motors and now recently Air India.

His role was well appreciated as he took various initiatives for the future growth of Tata Sons by involving himself in various plans and policy matters that involved crucial decision making like in Air India acquisition from Indian Government in January 2022.

His was well known for his workable managed equations with the Tata group. Well equipped with the group limitations, he always architected the solutions for the issues in a way an architect worked to restore the glory of a heritage building. So, he was unanimously elected as its chairman by the Tata Sons Board.

Sources: (i) https://economictimes.indiatimes.com/news/company/corporate-trends/n-chandrasekaran-appointed-chairman-of-tata-sons-for-a-second-term-of-five-years/articleshow/89499904.cms, dated: 11th February, 2022, accessed on 10.08.2022.

(ii) https://economictimes.indiatimes.com/industry/transportation/airlines-/-aviation/air-india-is-now-a-tata-property-69-years-after-the-group-ceded-control/articleshow/89153880.cms?from=mdr, dated: 27th January, 2022, accessed on 10.08.2022.

21.6.1 Relationship with the CEO

The Chairman should have good relations with the CEO, through which he/she can understand what is going on in the organization and determine whether the CEO is working toward achieving the set targets or not. Strained relations may turn out to be detrimental to the company. Differences may compel the CEO to withhold information from the Chairman.

21.6.2 Relationship with Executive Directors

The Chairman should maintain good relations with the executive directors to find out how effectively and efficiently the work is carried out by them. The Chairman should ensure that the executive directors report the organization's activities in an honest and transparent way.

21.6.3 Relationship with Non-executive Directors

A good Chairman should be able to attract and maintain good non-executive directors on his/her board. He/she should maintain cordial relations with them to motivate them to take decisions that benefit the company.

Check Your Progress-2

8. Directors usually accomplish their conformance role by questioning and supervising the ___.
   a. Chairman
   b. Manager

c. Executive management
d. Non-executive management

9. Which of the following responsibilities are common to directors all over the world?
   i. Contravention of the law
   ii. Responsibilities toward shareholders
   iii. Obligation to maintain honesty and integrity
   a. Only i and ii
   b. Only i and iii
   c. Only ii and iii
   d. i, ii and iii
10. According to Companies Act, directors are liable for which of the following activities?
   i. Exercise powers for a collateral purpose
   ii. Misrepresentations in offer documents and annual accounts
   iii. Failure to refund subscription money to investors
   iv. Contravention of the law
   a. Only i, ii and iii
   b. Only i, ii and iv
   c. Only i, iii and iv
   d. Only ii, iii and iv
11. Which of the following is not a duty of the director?
   a. Not to make secret profits and make good loss, if accrued due to breach of duty,of negligence
   b. Not to exercise powers for a collateral purpose
   c. Act in the best interest of the company and its stockholders and customers
   d. To protect interests of debtors
12. Which of the following is a duty of the director?
   i. Exercise care in the discharge of functions as directors
   ii. To exercise powers for a collateral purpose
   iii. Not to misuse power
   iv. Not to waste company assets
   a. Only i, ii and iii
   b. Only i, ii and iv
   c. Only i, iii and iv
   d. Only ii, iii and iv

21.7 Functions of the Chairman

Following are the functions of a Chairman.

- To set standards, and ensure that policies and practices are in place. To ensure that the directors make good decisions.
- To make sure that directors are continuously upgraded to the levels required by investors to meet the company's current and future needs.
- To act decisively during crisis.
- To act as the company's representative.

Example: ONGC Chairman Functions – Sensitized to Know Significance

The chairman functions are very vital for any company's sustainability and growth, especially for a company like ONGC (Oil and Natural Gas Company). ONGC, a public sector undertaking and India's top oil and gas producer, was on a hunt for an eligible chairman cum managing director to it. The vacancy arouse after Mr.Shashi Shankar's retirement on 31st March 2021.

The government headhunter PESB (Public Enterprise Selection Board) though interviewed senior bureaucrats, yet couldn't find an eligible candidate. On 19th June 2022, the ministry of petroleum and natural gas also brought a proposal to increase the eligibility of the candidate for this post, i.e. 60 years of age as on 1st April 2021 (date of vacancy occurrence). Also, proposed a need to specifically design 'sui generis' job description to attract the best talent available for this post.

On this, the ministry said that the chairman functions play a sensitive role in a company like ONGC where energy was the country's sensitive and vital resource. He should be in a position to steer the company in exploration as India's NOC (National Oil Company) by scaling its activities meticulously and rapidly.

Source:https://economictimes.indiatimes.com/industry/energy/oil-gas/oil-ministry-proposes-higher-age-limit-shorter-tenure-for-ongc-chairman/articleshow/92320262.cms, dated: 19th June, 2022, accessed on 10.08.2022.

Activity:

Do you agree, "A group of outstanding individuals always makes an effective board." What is the role of the chairman in the successful functioning of a board?

Answer:

____

____

21.8 The Role of CEO

The CEO has to run the organization efficiently to produce the desired results. He/she should also have a constructive working relationship with the Chairman and directors.

Example: Passion behind Godrej Properties 'in selecting' Mr. Pandey for CEO Role

On 2nd August 2022, Godrej Properties had announced changes to its leadership team w.e.f 1st January 2023.In this context, the company announced Mr. Gaurav Pandey, chief executive officer (CEO) of its north zone as its next managing director and CEO.

The company's decision was announced after a carefully carved study upon Mr. Gaurav's leadership performance as CEO's north zone. Mr. Gaurav's passion and leadership demonstration led to strong value deliverables for the company's north zone business. Prior to this, he also had 17 years of experience in real estate business besides carrying an economic and IIM degree with him. The company said that all this carries as his eligibility for the designate CEO role and anxiously looking forward for the next phase of company's growth under his leadership

Source: https://economictimes.indiatimes.com/news/company/corporate-trends/godrej-properties-makes-changes-to-leadership-team-elevates-gaurav-pandey-as-md-ceo/articleshow/93296411.cms, dated: 2nd August, 2022, accessed on 10.08.2022.

21.8.1 Relations with the Chairman

The CEO should establish a constructive working relationship with the Chairman by projecting a high degree of trust and respect. Both should have the ability to communicate openly with each other, and should know each other's strengths and weaknesses so that they can work together closely complementing each other to build the company's future.

21.8.2 Relation with Directors

The CEO should maintain cordial relations with the directors to ensure that they act in the organization's interests instead of that of the owners. These relations can be used to motivate the directors to actively participate in enhancing the performance of the entire organization.

21.9 Functions of the CEO

A CEO should carry out the following functions.

- Assist the executive directors in formulating strategic proposals, which have to be endorsed by the board.
- Provide leadership and direction to all his/her executive directors.
- Develop a plan for implementing the strategy formulated by the board and/or

management, and for convincing the non-executive directors that the strategy can work.

- Act as representative of the executive directors when interacting with the non-executive directors.
- Present the company to major investors, the media, and government.
- Be a source of inspiration, leadership, and direction to the employees, customers, and suppliers.
- Be able to identify the situations that require intervention.

Example: CEO Function in Uncertainties - Google Pichai, An Example

The first quarterly earnings of the year 2022 showed Google Inc.'s growth (23%) slowed down when compared to the same period of the last year (34%). Reacting to this, Google CEO, Mr.Sundar Pichai, gave a press release that the slow pace was due to uncertainty in the global economic outlook, henceforth no such impact would be on the existing employees. However, to protect Google from future adversities and meet its long-term goals, the company planned to slow down the hiring pace for the rest of the year 2022 and in 2023. The hiring focus would be more for critical roles like in engineering and technical segments to meet Google's long-term goals with the talent hired.

Source: https://www.ceotodaymagazine.com/2022/07/google-chief-explains-why-the-company-will-slow-hiring-in-2022-23/, dated: July 2022; accessed on 11.08.2022

Check Your Progress-3

13. Which of the following is the role of a Chairman of a company?
    - i. To manage the board and ensure that its policies are put into practice by the management
    - ii. To keep a strict watch on the company's actual performance
    - iii. To work closely with the chairman to address legal issues
    - iv. To have a clear idea of where the company stands and where it is headed

    - a. Only i, ii and iii
    - b. Only i, ii and iv
    - c. Only i, iii and iv
    - d. Only ii, iii and iv
14. Which of the following should/must be undertaken by a Chairman of a company?
    - i. Have a clear understanding of the way in which a company is managed
    - ii. Identify the virtue and see that the board discusses these
    - iii. Play a proactive role

iv. Play a crucial role in maintaining good relations between the board and the company's stakeholders

a. Only i, ii and iii

b. Only i, ii and iv

c. Only i, iii and iv

d. Only ii, iii and iv

14. Which of the following is a primary responsibility of the chairman?

i. Cater the internal needs of the board and its conduct

ii. To handle people from varied fields who serve the board

iii. He must have good interpersonal relations

a. Only i and ii

b. Only i and iii

c. Only ii and iii

d. i, ii and iii

15. Which of the following is not a function of the chairman?

a. To set standards and ensure that policies and practices are in place

b. To make good policies

c. To act decisively in times of crisis

d. To act as a representative of the company

21.10 Functions of the Board

The board is responsible for the organization's performance and should work to Promote its interests on shareholders' behalf, to whom it is accountable. The board oversees the performance of the organization, CEO, and top-level managers. It ensures that timely and accurate reports are provided on corporate performance, including financial conditions and non-financial indicators of the corporation.

It monitors corporate performance by closely monitoring the organization's progress against the pre-set goals and targets. The board provides strategic guidance to the corporation. It studies future trends so that the corporation has the required resourcesto secure its long-term position in the marketplace. The board has to maintain good relations with the stakeholders and try to keep the shareholders happy. The board also has various performance and conformance roles to play.

Example: IndusInd Board Approved IndusInd's Fund Raising Proposal

On 18th July 2022, IndusInd Bank, a private sector bank, sought the approval of its Board (Board of Directors) meeting, for its proposal to raise Rs.20,000 crore in debt to fund its business expansion. The board took note of the bank's proposal and approved to raise the fund but in debt securities and, on a permitted private placement and mode.

Source: https://economictimes.indiatimes.com/industry/banking/finance/banking/indusind-bank-board-gives-nod-to-mobilise-rs-20000-crore/articleshow/92962674.cms, dated: 18th July, 2022, accessed on 11.08.2022.

21.10.1 Strategic Role of the Board

The board has a final say in the strategy that decides the company's future. It has the right to either pass the decisions taken by the executives or question their effectiveness. The executives should therefore come up with proposals that will convince the board, in order to make an improvement in using their collective experience and expertise in various fields of business. The board, thus, plays a keyrole in leading and directing the organization. Effective boards are familiar with the organization's activities. And so, play a major role in guiding its strategic decision-making process. Sometimes, non-executive directors warn the CEO about operational issues that would create a crisis. The board carries out its role in the strategy development in the following levels.

Systematic level strategy is based on the board's understanding of what is happening in the national, international, and global environments. This knowledge extends to many areas the socio-political environment, potential market trends, the impact of changes in technology, and the international competitive forces that have an effect on the company. By scanning the external environment regularly, board members can provide the top management with vital inputs for effective decision making.

Structural and portfolio strategy is concerned with decisions regarding the company's structure and the businesses that it should enter into. The board addresses issues like what changes can be made in the company's structure to achieve its growth aspirations. This level involves discussions among the board and the management about mergers, acquisitions, strategic alliances, or sale of a part of business.

Implementation strategy is concerned with ensuring that the strategy is feasible. The board ensures that a broad game plan for implementing the policies and strategies is in place so that the management can deliver the desired results.

Policy Making Role of the Board

The board frames guidelines or policies to ensure that the business plans and management decisions conform to the corporate strategy. These policies cover all the key areas like marketing, finance, personnel, operations, customer relations, and research and development. The board develops broad policies for these areas and the executives of the organization draw up derived policies (pricing, advertising, sales and distribution in the marketing field). These policy statements are usually published and made available to employees.

Monitoring and Supervisory Role

The board monitors and supervises the organization to ensure that it adopts the right strategic direction. It regularly checks whether the business is following the policies laid down for goal achievement, and inquiries into the causes of deviations. The board reviews the organization's plans, policies, and strategies with the changing environment. It also makes changes in the company's strategies, if required. To ensure effort supervision, a board has to monitor all the company's activities that are for ensuring consistent growth and building market share.

Check Your Progress-4

17. Which of the following is the primary role of a CEO?
    - a. Run the organization in an efficient manner to produce the desired results
    - b. Set standards and ensure that policies and practices are in place
    - c. Ensure that director make good decision
    - d. Act as a representative of the company
18. Which of the following is not a function of the CEO?
    - i. To assist the non-executive directors in formulating strategic proposals that has tobe endorsed by the board
    - ii. To provide leadership and direction to all his/her executive directors
    - iii. To develop a plan for implementing the strategy formulated by the board and/ormanagement, and to convince the executive directors that the strategy can work
    - a. Only i and ii
    - b. Only i and iii
    - c. Only ii and iii
    - d. i, ii and iii
19. Which of the following is a function of the CEO?
    - i. To act as representative of the non-executive directors when interacting with theexecutive directors.
    - ii. To present the company to major investors, the media and government.
    - iii. To be a source of inspiration, leadership and direction to the employees,customers and suppliers.
    - iv. To be able to identify the situations that requires intervention.
    - a. Only i, ii and iii

b. Only i, ii and iv
c. Only i, iii and iv
d. Only ii, iii and iv

20. Which of the following statements about the functions of the board is false?
    a. It takes the responsibility for the performance of the corporation and work topromote its interests on behalf of the shareholders, to whom it is accountable.
    b. It ensures that timely and accurate reports are provided on corporate performance, including the financial conditions and non-financial indicators of the corporation.
    c. It monitors corporate performance by closely following the progress of thecorporation towards the pre-set goals and targets.
    d. It studies the future trends so that the corporation has the necessary and adequateresources to secure its immediate position.
21. Which of the following level strategy formulations is based on the board's understanding of what is happening in the national, international, and global environment?
    a. Systematic
    b. Structural
    c. Implementation
    d. Portfolio
22. Which of the following strategies is concerned with the board's role in ensuring that the strategy is feasible?
    a. Systematic
    b. Structural
    c. Implementation
    d. Portfolio
23. Which of the following statements is false?
    a. Structural and portfolio strategy is concerned with decisions regarding the structure of the company and the businesses that it should enter into.
    b. In implementation strategy, the board addresses issues like what changes can be done in the structure of the company to achieve the growth aspirations of the board.
    c. Systematic level strategy formulation based on the board's understanding of what is happening in the national, international, and global environment.
    d. None of the above

21.11 Committees of the Board

The board relies on independent outside directors to monitor management performance. Following are some important committees usually set up by the board, comprising outside directors -- audit committee, remuneration committee, and nomination committee.

21.11.1 Audit Committee

The audit committee usually comprises independent directors who report to the board. These committees act as a link between the board and the external auditors. The committee examines the matters raised by the external auditors relating to the management systems and tries to resolve any objections that the auditors raise about the published financial accounts. Following are some functions of a corporate audit committee.

- To discuss with independent auditors any problems that they experience in completing the audit.
- To review the interim and final accounts completely.
- To inform the board about the effectiveness of internal controls and the quality of financial reporting as pointed out by the independent auditors.
- To make recommendations regarding the audit fee, and selection and replacement of auditors.

Example: AMCs Audit Committee

On 9th February 2022, SEBI (Securities and Exchange Board of India), securities market regulator, released a mandate for AMCs (Asset Management Companies). The regulator asked the AMCs to form an audit committee to review its financial reporting process, internal control systems and audit process for its MF (Mutual fund) operations. The committee would be held responsible for its functions like any oversight of financial reporting and audit processes, and non-compliance with its applicable rules and regulations. The mandate was effective from 1st August 2022.

Source:https://economictimes.indiatimes.com/mf/mf-news/sebi-directs-amcs-to-form-audit-committee-from-august/articleshow/89460745.cms?from=mdr., dated: 9th February, 2022, accessed on 11.08.22.

21.11.2. Remuneration Committee

Shareholders are becoming concerned about the lack of transparency regarding the remuneration of directors and top-level managers. A remuneration committee is set up by the board comprising independent directors. The committee designs a transparent remuneration policy that can attract and retain directors and other top level-officials, and motivate them to achieve the long-term goals of the organization. The committee reviews the remuneration packages of the executive directors and other top-level managers, and checks any unreasonable increases in their remuneration.

21.11.3. Nomination Committee

These are usually set up to select the new non-executive directors. Usually, it is headed by the Chairman, and it shortlists and interviews the final candidates.

Check Your Progress-5

24. Which of the following statements is true?
    i. The board of directors frames guidelines or policies to ensure that the business plans and management decisions conform to the corporate strategy
    ii. The board reviews the plans, policies and strategies of the corporation in the light of the changing competitive environment
    iii. For effective executive supervision, a board has to monitor all the activities of the company that are crucial for ensuring consistent growth and building market share
    a. Only i and ii
    b. Only i and iii
    c. Only ii and iii
    d. i, ii, and iii
25. Which of the following is not a committee set up by the board, comprising outside directors?
    a. Audit committee
    b. Portfolio committee
    c. Remuneration committee
    d. Nomination committee
26. The ___________committee looks into all the matters raised by the _____________ auditors relating to the management systems and tries to resolveany objections that the auditors raise about the published financial accounts.
    a. Audit, internal
    b. Audit, external
    c. Tax, internal
    d. Tax, external
27. Which of the following is not a function of the corporate audit committee?
    a. To discuss with internal auditors any problems that they experience in completingthe audit
    b. To inform the board about the effectiveness of internal controls and the quality offinancial reporting as pointed out by the independent auditors

c. To make recommendations regarding the audit fee, selection and replacement ofauditors

d. None of the above

28. The remuneration committee designs a transparent remuneration policy that canattract and retain directors and top management and motivate them to achieve which of the following goals of the organization?

a. Immediate

b. Short-term

c. Mid-term

d. Long-term

29. Nomination committees are set up to select the new___ directors and it is usually headed by the ____________________________.

a. Executive, CEO

b. Non-executive, chairman

c. Executive, president

d. Non-executive, manager

Activity: Ashok Pumps Private Limited was earning good profits before the liberalization of the Indian economy. Post liberalization) it faced many problems and its profits declined. To manage the company efficiently, the company decided to form various board committees to improve the performance of the board. What committees should Ashok Pumps set up to improve its performance?

Answer:

____

____

____

____

21.12 Summary

- A director assumes two roles -- performance role and conformance role -- while governing the activities of an organization.
- The company law lays down the duties and responsibilities of the board. These are -- responsibilities to shareholders and obligation to maintain honesty and integrity.

- According to the Companies Act, directors are liable for misrepresenting offer documents and annual accounts, failing to refund subscription money to investors, and contravening the law.
- Directors should exercise care in the discharge of their functions, not misuse power, protect the interests of creditors, maintain confidentiality, etc.
- The Chairman should manage the board and ensure that its policies are put into practice by the management. He/she should have good relationships with theCEO, executive directors, and non-executive directors.
- A Chairman should set standards, and ensure that policies and practices are in place; act decisively during a crisis; act as the company's representatives; etc.
- The CEO has to run the organization efficiently to produce the desired results. He/she should also have a constructive working relationship with the Chairman and directors.
- A CEO should provide leadership and direction to all his/her executive directors; be able to identify the situations that require intervention; present the company to major investors, the media, and government; etc.
- The board is responsible for the organization's performance and should work to promote its interests on behalf of the shareholders to whom it is accountable. It plays the following roles -- strategic, policy making, and monitoring and supervisory.
- The board relies on independent outside directors to monitor management performance. The board usually sets up the following committees comprising outside directors -- audit committee, remuneration committee, and nomination committee.

21.13 Glossary

Conformance role of a director: In the conformance role, the director should ensure that the company follows the policies and procedures laid down by the board by questioning and supervising the executive management. The conformance role is very tricky as it involves monitoring and evaluating own performance (in case of majority/all-executive boards).

Implementation strategy: It is concerned with ensuring that the strategy is feasible. The board ensures that a broad game plan for implementing the policies and strategies is in place so that the management can deliver the desired results.

Performance role of a director: In the performance role, the director carries out various activities that are aimed at enhancing the organization's overall performance. The director acts as a source of expertise and external information. He/she also caters to the organizational needs for networking, representing, and enhancing status.

Structural and portfolio strategy: It is concerned with decisions regarding the company's structure and the businesses that it should enter into.

Systematic level strategy: It is based on the board's understanding of what is happening in the national, international, and global environments.

21.14 Self-Assessment Test

1. The board of directors is responsible for ensuring good corporate governance. This involves a set of relationships between the management of a corporation, its board, and its stakeholders. Explain the roles and responsibilities of directors.
2. Directors are liable for certain things, and should carry out certain duties. What are the duties of the directors?
3. The Chairman should manage the board and should have good interpersonal relations. What are the functions of a Chairman? Explain the role played by the Chairman in ensuring the effective functioning of the board.
4. Explain the relationship of the Chairman with the CEO, executive directors, and non-executive directors.
5. The CEO has to run the organization efficiently to produce the desired results. Explain the relationship of the CEO with the Chairman and the directors. List out the functions of the CEO.
6. The board oversees the performance of the organization, CEO, and top-level managers. Explain in detail the functions of the board.
7. What are the various committees that are set up by the board?

21.15 Suggested Readings / Reference Material

1. K P Muraleedharan, E K Satheesh (2022). Fernando's Business Ethics and Corporate Governance, Pearson India. 3rd edition
2. Manuel G. Velasquez (2021). Business Ethics – Concepts and Cases. Pearson Education, 8th edition
3. K Viyyanna Rao & G Naga Raju (2020). Business Ethics and Corporate Governance. 1st edition. Wiley
4. Jyotsna GB & RC Joshi (2020). Business Ethics and Corporate Governance. McGraw Hill India. 1st edition
5. Sandeep Goel (2020). Corporate Governance. McGraw Hill India. 1st edition

21.16 Answers to Check Your Progress Questions

1. **(a) Honesty, enterprise**

   Good corporate governance requires that the board must govern the corporation with honesty and enterprise in a manner, which confirms and enhances the authority with which it has to function.

2. (d) **Long-term**

   The way in which the board handles issues related to business ethics to environment protection may affect the interest of certain groups (stakeholders) and this in turn may have an influence on the reputation and long-term interests of the business enterprise.

3. (c) **Only ii and iii**

   A director assumes two roles while governing the activities of an organization performance role and conformance role.

4. (b) **Performance**

   In performance role, the director performs various activities that are aimed at improving the overall performance of the corporation.

5. (a) **Only i and ii**

   In performance role, the director performs various activities that are aimed at improving the overall performance of the corporation. Firstly, a director act as a source of expertise and external information, secondly, he caters to needs of the corporation for networking, representing, and enhancing status. In conformance role, the directors usually question and supervise the executive management ensuring that the company follows the policies and procedures laid down by the board.

6. (b) **He brings in information related to national markets, the financial or technological environment etc., which are readily accessible to the corporation.**

   The directors act as specialists, who provide their expertise, knowledge, and skills to various areas such as finance, marketing, law, and engineering. They bring in information related to international markets, the financial or technological environment etc., which is not readily accessible to the corporation. They represent the company on public forums or committees and also act with the media on behalf of the corporation. As they are renowned in a particular field, their presence enhances the status, reputation, and credibility of the board. This boosts customer/shareholder confidence in the company.

7. (a) **Conformance**

   In conformance role, the director is concerned with ensuring that the company follows the policies and procedures laid down by the board.

8. (c) **Executive management**

   In conformance role, the director is concerned with ensuring that the company follows the policies and procedures laid down by the board. He usually accomplishes this by questioning and supervising the executive management.

9. (c) Only ii and iii

The responsibilities of the directors differ from country to country, but there are some responsibilities that are common to directors all over the world. These are: responsibilities to shareholders and obligation to maintain honesty and integrity. Though directors are liable for contravention of the law it differs from country to country according to its legislation.

10. (d) Only ii, iii, and iv

The companies act makes directors liable for the following: misrepresentations in offer documents and annual accounts; failure to refund subscription money to investors; contravention of the law; and not to exercise powers for a collateral purpose.

11. (d) To protect interests of debtors

Duties of a director are: not to make secret profits and make good loss, if accrued due to breach of duty, of negligence; not to exercise powers for a collateral purpose; act in the best interest of the company and its stockholders and customers; and to protect interests of creditors.

12. (c) Only i, iii, and iv

Duties of a director are: exercise care in the discharge of functions as directors; not to exercise powers for a collateral purpose; not to misuse power; and not to waste company assets.

13. (b) Only i, ii, and iv

The role of the chairman is to manage the board and ensure that its policies are put into practice by the management. He also has to work closely with the company secretary to address legal issues. The chairman must have a good understanding of the financial standing of the company. He must keep a strict watch on the company's actual performance. The chairman should have a clear idea of where the company stands and where it is headed.

14. (c) Only i, iii, and iv

A chairman should have a clear understanding of the way in which a company is managed. He must identify shortcomings and see that the board discusses these.A chairman should play a proactive role. By being proactive the chairman can help the CEO take corrective action before things get out of hand. The chairman also plays a crucial role in maintaining good relations between the board and the company's stakeholders, In the process of maintaining such relations, he ensures that the board makes decisions in accordance with the interest of shareholder and all other stockholders of the company.

15. (d) i, ii, and iii

The primary responsibility of the chairman lies in catering to the internal needs of the board and its conduct. He has to handle people from varied fields who serve the board. A chairman must have good interpersonal relations. For ensuring functioning of the board, a chairman should forge good relationships with the CEO, executive and non-executive directors.

16. (b) To make good policies

Functions of a chairman are: to set standards and ensure that policies and practices are in place; to act decisively in times of crisis; to act as a representative of the company; and to ensure that the policies are put into practice by the management.

17. (a) Run the organization in an efficient manner to produce the desired results

The primary role of a CEO is to run the organization in an efficient manner to produce the desired results. It is the functions of a chairman to set standards and ensure that policies and practices are in place; to ensure that directors make good decision; and to act as a representative of the company.

18. (c) Only ii and iii

Functions of the CEO are: to assist the executive directors in formulating strategic proposals that have to be endorsed by the board; to provide leadership and direction to all his executive directors; and to develop a plan forimplementing the strategy formulated by the board and/or management, and to convince the non-executive directors that the strategy can work.

19. (d) Only ii, iii, and iv

Functions of the CEO are: to act as representative of the executive directors when interacting with the non-executive directors; to present the company to major investors, the media and government; to be a source of inspiration, leadership and direction to the employees, customers and suppliers; and to be able to identify the situations that requires intervention.

20. (d) It studies the future trends so that the corporation has the necessary and adequate resources to secure its immediate position

The Board of directors takes the responsibility for the performance of the corporation and work to promote its interests on behalf of the shareholders, to whom it is accountable. The board ensures that timely and accurate reports are provided on corporate performance, including the financial conditions and non- financial indicators of the corporation.

It monitors corporate performance by closely following the progress of the corporation towards the pre-set goals and targets and studies the future trends so that the corporation has the necessary and adequate resources to secure its long-term position.

21. (a) Systematic

Systematic level strategy formulation is based on the board's understanding of what is happening in the national, international, and global environment.

22. (c) Implementation

Implementation strategy is concerned with the board's role in ensuring that the strategy is feasible.

23. (b) In implementation strategy, the board addresses issues like what changes can be done in the structure of the company to achieve the growth aspirations of the board

Structural and portfolio strategy is concerned with decisions regarding the structure of the company and the businesses that it should enter into. The board addresses issues like what changes can be done in the structure of the company to achieve the growth aspirations of the board. Systematic level strategy formulation is based on the board's understanding of what is happening in the national, international and global environment. Implementation strategy is concerned within the board's role in ensuring that the strategy is feasible.

24. (d) i, ii, and iii

The board of directors frames guidelines or policies to ensure that the business plans and management decisions conform to the corporate strategy. The board reviews the plans, policies and strategies of the corporation in the light of the changing competitive environment. If necessary, it makes changes in the corporations' strategies. For effective executive supervision, a board has to monitor all the activities of the company that are crucial for ensuring consistent growth and building market share.

25. (b) Portfolio committee

Committees comprising of outside directors, set up by the board are: audit committee; remuneration committee; and nomination committee.

26. (b) Audit, external

The committee usually consists of independent directors who report to the board. These committees act as a link between the board and the external auditors. The audit committee looks into all the matters raised by the external auditors relating to the management systems and tries to resolve any objections that the auditors raise about the published financial accounts.

27. (a) To discuss with internal auditors any problems that they experience incompleting the audit

The functions of a corporate audit committee are: to discuss with independent auditors any problems that they experience in completing the audit; to inform the board about the effectiveness of internal controls and the quality of financial reporting as pointed out by the independent auditors; and to make recommendations regarding the audit fee, selection and replacement of auditors.

28. (d) Long-term

The remuneration committee designs a transparent remuneration policy that can attract and retain directors and top management and motivate them to achieve the long-term goals of the organization.

29. (b) Non-executive, chairman

Nomination committees are set up to select the new non-executive directors. Usually, it is headed by the chairman and he/she shortlists and interviews the final candidates.

Unit 22

Corporate Governance-Codes and Laws

Structure

"Good corporate governance, it's about being proper and prosper."

\- Toba Beta, Author

22.1 Introduction

The quote clearly showcases that the corporate governance will be for corporate good, when its design is on par with the business environment changes. Hence, the unit reflects the same by providing different corporate governance codes.

In the previous unit, we have discussed the roles and responsibilities of directors. In this unit, we shall discuss the codes and laws pertaining to corporate governance.

A code is a set of written rules that are accepted as general principles or which state how people in a particular organization or country should behave. It is a set of standards agreed upon by a group of people who do a particular job. A regulation is an official rule that lays down how things should be done. Codes and regulations are sets of rules, principles, or standards that are intended to control, guide, or manage behavior or the conduct of individuals working in organizations, the basic difference between the two being that codes are self-imposed or self-regulated, while regulations are official, i.e., imposed by the State. Most codes have been developed by NGOs, promoted or commissioned by stock exchanges, investor groups, and professional associations. Governments also issue rules or guidelines on matters regarding governance through capital market regulatory organizations like SEBI.

This unit will first discuss the self-regulatory codes. We shall then move on to discuss the various reports of committees on Corporate Governance such as the Kumar Mangalam Birla committee report, the CII report, the Cadbury report, and the OECD report. Finally, we shall discuss the corporate governance and company law.

22.2 Objectives

By the end of this unit, you should be able to:

- Explain about the self-regulatory codes.
- Discuss the various reports of committees on Corporate Governance
- Discuss about corporate governance and company law.

22.3 Self-Regulatory Codes

Codes are generally self-regulatory and are meant to guide conduct or behavior. They do involve some official authority directing or controlling behavior. Listed here are the benefits of self-regulation:

- With self-regulation, ethical standards can be imposed which can go beyond those imposed by statutory legislation.
- Self-regulators are directly accountable to their group members. Self-regulatory systems have built in motivation to regulate for effectiveness and least interference.
- Self-regulation operates in an environment where people are willing to accept regulations formulated from within for the common good of the group.
- Self-regulators, being part of the group, understand the issues facing the group thoroughly and are therefore more sensitive to its needs.
- The regulated can participate at all levels of the self-regulatory process. This enables them to appreciate and accept new regulations.
- Self-regulation has a built-in system of checks and balances as the regulated see it as their duty to expose non-compliance.
- Self-regulators can identify complex regulatory problems at an early stage and develop suitable solutions before these problems start disrupting group operations.
- Self-regulations are more comprehensive than official regulations, and are easier to operate and implement.

Example: Self-regulatory Induction in Leonardo

In Leonardo Corporate Governance Report 2021, it was reported that as per its Board's rules of procedure, the Chairman of Leonardo ensures the organization that a properly designed induction sessions would be organized for all its directors and statutory auditors for inducting a self-regulatory framework in them. This was in addition to the other items in his session agenda. These sessions would be conducted at regular intervals.

These sessions were to provide them with and strengthen adequate knowledge concerning business sector in which the company operates, related evolution, the standards for a proper risk management and the applicable legislative framework. This developed a built-in system of checks and balances as the regulated see while performing their duties.

Source: https://www.leonardo.com/documents/15646808/16736138/RCG+2022_EN_.pdf?t=1647274285985; Dated: 10th March, 2022, accessed on 29.07.2022.

22.4 Reports of Committees on Corporate Governance

Losses suffered by investors and lenders in the early 2000s post the Enron and WorldCom debacles raised concerns about the standards of financial reporting and accountability of management. Many believed that these losses could have been avoided if the companies had had transparent reporting practices and good corporate governance.

Governments and corporates have made sincere efforts to design corporate codes to govern the functioning of corporations. Following are the important corporate governance reports published in India and abroad.

22.4.1 Cadbury Committee Report

In May 1991, a committee was set up in the UK under the Chairmanship of Adrian Cadbury by the Financial Reporting Council, the London Stock Exchange, and the accountancy profession to look into the financial aspects of corporate governance. The committee submitted its first report for public scrutiny on May 27, 1992. Following are its recommendations.

- Decision-making power should not be vested in a single person. The roles of Chairman and Chief executive officer should be separated.
- Non-executive directors should act independently while giving their judgment on issues of strategy, performance, allocation of resources, and designing codes of conduct.
- A majority of directors should be independent non-executive directors, i.e., they should not have any financial interests in the company.
- The term of a director should not exceed three years. Any extension can be

given only with the prior approval of the shareholders.

- Matters relating to directors' emoluments should be fully transparent. There should be a judicious mix of salary and performance related pay.
- A remuneration committee made up of all or most of the non-executive directors, should decide on the pay of the executive directors.
- The interim report should give the balance sheet information and should be reviewed by the auditor.
- The pension funds should be managed distinct from the company.
- There should be a professional and an objective relationship between the Boardand the executives.
- Information regarding the audit fee should be made public and there should beregular rotation of auditors.

The committee's recommendations were widely accepted by corporates in the UK, and they became a reference point for many other committees, which were set up by various governments worldwide.

22.4.2 CII Report

With liberalization and growth in competition, the Indian industry began to recognize the importance of corporate governance for enhancing its ability to compete in the global marketplace. The CII drafted some codes of corporate governance. In mid- 1996, a national task force on corporate governance was set up under the leadership of Rahul Bajaj, Ex-President of CII and Chairman and Managing Director, Bajaj Auto Limited. Given here are some of its recommendations.

1. The entire Board should meet at least six times a year, i.e., once every two months. Each meeting should comprise agenda items that need at least half a day s discussion.
2. Any listed company with a turnover of Rs. 1 billion and higher should have professionally competent, independent, non-executive directors, who should constitute at least 30% of the Board if the Chairman of the company is a non-executive director, or at least 50% of the Board if the Chairman and managing director is the same person.
3. No single person should hold directorships in more than ten companies. This ceiling excludes directorships in subsidiaries (where the group has over a 50% equity stake) or associate companies (where the group has over 25% but no more than a 50% equity stake).
4. For non-executive directors to play a material role in corporate decision making and maximizing long term shareholder value, they need to become active participants on the Board, not passive advisors; have clearly defined

responsibilities within the Board such as the audit committee; and the know-how to read and understand a balance sheet, profit and loss account, cash flow statements, and financial ratios; and have some knowledge of various company laws. This, of course, excludes those who are invited to join the Board as an expert in other fields such as science and technology.

- To secure better effort from non-executive directors, companies should pay a commission over and above the sitting fees for the use of professional inputs. The present commission of 1% of net profits (if the company has a managing director), or 3% (if there is no managing director) is sufficient. Companies can also offer stock options, so as to relate rewards to performance. Commissions are rewards on current profits. Stock options are rewards contingent upon future appreciation of corporate value. An appropriate mix of the two can ensure that a non-executive director will keep an eye on short-term profits as well as long-term shareholder value.
- While re-appointing members of the Board, companies should give the attendance record of the concerned directors. If a director has not been present (absent with or without leave) for 50% or more meetings, then this should be explicitly stated in the resolution that is put to vote. Generally, a director who had not attended even one half of the meetings should not be re-appointed.
- Given here is the key information that should be reported and placed before the Board.

5. Annual operating plans and budgets, together with updated long-term plans Capital budgets, manpower and overhead budgets
6. Quarterly results for the entire company and its operating divisions or business segments
7. Internal audit reports, including cases of theft and dishonesty of a material nature
8. Show cause, demand and prosecution notices received from revenue authorities that are considered to be materially important. (Material nature of any exposure is that which exceeds 1% of the company' s net worth.)
9. Fatal or serious accidents, dangerous occurrences, and any effluent or pollution problems
10. Default in payment of interest or non-payment of the principal on any public deposit, and/or to any secured creditor or financial institution
11. Defaults such as non-payment of inter-corporate deposits by or to the company, or materially substantial non-payment for goods sold by the company

12. Any issue which involves possible public or product liability claims of a substantial nature, including any judgment or order which may have either passed restrictions on the conduct of the company, or taken an adverse view regarding another enterprise that can have negative implications for the company
13. Details of any joint venture or collaboration agreement
14. Transactions that involve a substantial payment toward goodwill, brand equity, or intellectual property
15. Recruitment and remuneration of senior officers just below the Board level, including appointment or removal of the chief financial officer and the company secretary
16. Labor problems and their proposed solutions
17. Quarterly details of foreign exchange exposure and the steps taken by the management to limit the risks of adverse exchange rate movement, if material

Listed companies with either a turnover of over Rs. 1 billion or a paid-up capital of Rs. 200 million should set up audit committees within two years.

Audit committees should comprise at least three members, all drawn from a company s non-executive directors, who should have adequate knowledge of finance, accounts, and basic elements of company law.

To be effective, the audit committee should have clearly defined terms of reference and its members must be willing to spend more time on the company's work vis-à-vis other non-executive directors.

Audit committees should assist the Board in fulfilling its functions relating to corporate accounting and reporting practices, financial and accounting controls, and financial statements and proposals that accompany the public issue of any security, and thus provide effective supervision of the financial reporting process.

The audit committee should periodically interact with the statutory auditors and the internal auditors to ascertain the quality and veracity of the company s accounts as well as the capability of the auditors themselves.

For the audit committee to discharge its fiduciary responsibilities with due diligence, it must be incumbent upon the management to ensure that members of the committee have full access to financial data of the company and its subsidiaries and associated companies, including data on contingent liabilities, debt exposure, current liabilities, loans, and investments.

1. Listed companies with either a turnover of over Rs. 1 billion or a paid-up capital of Rs. 200 million, should have in place a strong internal audit department, or an external auditor to carry out internal audits. Without these, any audit committee will be incapable.

2. Under "Additional Shareholders Information," listed companies should give data on high and low monthly averages of share prices in a major stock exchange where the company is listed for the reporting year. Data pertaining to business segments, up to 10% of turnover, giving share in sales revenue, review of operations, analysis of markets, and future prospects should also be provided.
3. Consolidation of group accounts should be optional and subject to the financial institutions allowing companies to leverage on the basis of the group's assets and the income tax department using the group concept in assessing corporate income tax. If a company chooses to voluntarily consolidate, it should not be necessary to annex the accounts of its subsidiary companies under Section 212 of the Companies Act. However, if a company consolidates, then the definition of group should include the parent company and its subsidiaries (where the reporting company owns over 50% of the voting stake).
4. Major Indian Stock Exchanges should insist upon a compliance certificate signed by the CEO and CFO which clearly states that the management is responsible for the preparation, integrity, and fair presentation of the financial statements and other information in the annual report, and which also suggests that the company will continue in business in the course of the following year; the accountingpolicies and principles conform to standard practice, and where they do not, full disclosure has been made of any material departures; the Board has overseen the company s system of internal accounting and administrative controls systems either directly or through its audit committee (for companies with a turnover of Rs. 1 billion or paid-up capital of Rs. 200 million).
5. For all companies with a paid-up capital of Rs. 200 million or more, the qualityand quantity of disclosure that accompanies a GDR issue should be the norm for any domestic issue.
6. Government must allow far greater funding to the corporate sector against the security of shares and other paper.
7. It would be desirable for financial institutions as pure creditors to re-write their covenants to eliminate having nominee directors except in the event of serious and systematic debt default and in cases of the debtor company not providing six monthly or quarterly operational data to the concerned financial institutions.
8. If any company goes to more than one credit rating agency, then it must divulge in the prospectus and issue document the rating of all the agencies that carried out such an exercise. It is not enough to state the ratings. They must be given in a tabular format and show where the company stands relative

to higher and lower ranking. It makes considerable difference to an investor to know whether the rating agency or agencies placed the company in the top, middle, or bottom slots. It is essential that we look at the quantity and quality of disclosures that accompany the issue of company bonds, debentures, and fixed deposits in the USA and Britain -- if only to learn what more can be done to inspire confidence and create an environment of transparency. Finally, companies that are making foreign debt issues cannot have two sets of disclosure norms -- an exhaustive one for the foreigners and a relatively minuscule one for Indian investors.

9. Companies that default on fixed deposits should not be permitted to accept further deposits and take inter-corporate loans or make investments, and declare dividends until the default has been made good.
10. There should be a reduction in the number of companies where there are nominee directors. Financial institutions have often pointed out that they are on the Boards of too many companies and that they have too few competent officers to do thetask properly. So, in the first instance, financial institutions should take a policy decision to withdraw from Boards of companies where their individual shareholding is 5% or less, or the total financial institutions holding is under 10%.

Check Your Progress-1

1. Which one of the following is described as self-regulatory rules for guidingemployee conduct or behavior?
   a. Official statements
   b. Laws
   c. Rules
   d. Codes
2. The CII committee report, the Cadbury Committee report, and the OECD report address issues related to which of the following?
   a. Environmental ethics
   b. Corporate governance
   c. Corporate responsibility
   d. Ethics at workplace
3. Which one of the following statements regarding the recommendations made bythe Cadbury Committee about the composition of the board is not true?
   a. The majority of the members of the board of directors should be independentnon-executive directors
   b. The directors' term on the board should not exceed three years

c. The pension funds should be managed distinct from the company
d. The directors can have financial interests in the company

22.4.5 OECD Report

In a meeting held in April 1998, OECD ministers asked the OECD to develop a set of corporate governance principles that could be useful to both member and non-member countries. In June 1998, the OECD ad-hoc Task Force on Corporate Governance was set up with representatives from all member countries, key international organizations like the World Bank, private sector, and labor representatives with special expertise in corporate governance. Though the principles were primarily aimed at governments, they also provided guidance for stock exchanges, investors, private companies, and national commissions on corporate governance as they dealt with best practices, listing requirements, and codes of conduct. The OECD principles fall into five broad areas -- rights of shareholders, equitable treatment of shareholders, role of stakeholders, disclosure and transparency, and responsibilities of the Board.

The rights of shareholders

The corporate governance framework should protect shareholders' right. Protection of shareholders' right and shareholders' ability to influence company's behavior are vital for effective corporate governance.

Shareholders have the right to secure ownership, register shares, and share the residual profits of the company. They also have the most important right to participate in the basic decisions concerning the company, chiefly by participation in general shareholder meetings. The principles call for disclosure of corporate structures and devices that redistribute control over the company in ways that deviate from proportionality to ownership. Transfer of controlling interest in the company should be carried out under fair and transparent conditions and anti-takeover defenses should not be used to shield management from accountability. Investors should use their voting rights as even large shareholders can have no effective role in shaping major decisions affecting the company if they fail to vote.

The equitable treatment of shareholders

The corporate governance framework should ensure that all shareholders minority and foreign are equally treated. In case of violation of their rights, all shareholdersshould be able to obtain effective redressal.

Controlling shareholders, boards, and the management generally use their control over the company, and the information they have to the detriment of non-controllingand foreign investors. The principles stipulate that the board members, management, and controlling shareholders should deal fairly with all shareholders. Insider trading and self-dealing should also be prohibited. Maximum transparency should be provided to the distribution of voting rights among all categories of shareholders and the ways in which the voting rights are exercised.

The role of stakeholders

The corporate governance framework should recognize the stakeholders' rights (as established by law) and encourage active cooperation between corporations and stakeholders in creating wealth, jobs, and financially sound enterprises.

One key aspect of corporate governance is to ensure the flow of outside capital to firms. However, a good corporate governance structure should also find ways to encourage the various stakeholders in the firm to make the much-needed investment in human and physical capital. The competitiveness and ultimate success of a company is the result of teamwork. Teamwork draws contributions from a range of different sources -- investors, employees, creditors, and suppliers. Firms should recognize that their stakeholders constitute a valuable resource for building competitive and profitable companies in the long run, whether or not they are legally part of the corporate governance structure.

Disclosure and transparency

The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.

Transparency is widely recognized as a central and indispensable element of an effective corporate governance system. The Principles require the timely and accurate disclosure of information on all material matters regarding the financial situation, performance, ownership, and governance of the company. This information should be prepared in accordance with high quality standards. The Principles also require an annual independent audit so as to impose an external, objective control on the preparation and presentation of financial statements.

The role of the Board

The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the Board, and the Board's accountability to the company and the shareholders.

The Board is the main mechanism to monitor management and provide strategic guidance to the company. The OECD has a number of different Boards. Some Boards emphasize the monitoring of management conduct while other Boards are more concerned with providing a strategic vision for the corporations. The accountability of the Board to the company and its shareholders is a basic tenet of sound corporate governance everywhere. The principles clearly state that the Board should act and deal fairly with all shareholder groups and stakeholders, and assure compliance with applicable laws. The responsibilities of the Board include -- reviewing corporate strategy and planning; overseeing management (including remuneration); managing potential conflicts of interest; and assuring the integrity of accounting, reporting, and communication systems. The principles also stress the need for objective judgment on corporate affairs by Board members, independent of the management's opinion.

[1]In 2015, OECD released the G20 /OECD Principles of Corporate Governance. The principles are intended to help policymakers evaluate and improve the legal, regulatory, and institutional framework for corporate governance, with a view to support economic efficiency, sustainable growth and financial stability. These are a set of six principles:

1. Ensuring the basis for an effective corporate governance framework - The corporate governance framework should promote transparent and fair markets, and the efficient allocation of resources. It should be consistent with the rule of law and support effective supervision and enforcement.
2. The rights and equitable treatment of shareholders and key ownership functions - The corporate governance framework should protect and facilitate the exercise of shareholders' rights and ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.
3. Institutional investors, stock markets, and other intermediaries - The corporate governance framework should provide sound incentives throughout the investment chain and provide for stock markets to function in a way that contributes to good corporate governance.
4. The role of stakeholders in corporate governance - The corporate governance framework should recognise the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.
5. Disclosure and transparency - The corporate governance framework should ensure that timely and accurate disclosure is made by the company on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.

[1] *https://www.oecd-ilibrary.org/docserver/9789264236882-en.pdf?expires=1674392491&id=id&accname=guest&checksum=C6CA3A08F53103332F241C71D72F326D*

6. The responsibilities of the Board - The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

The OECD Corporate Governance Committee is reviewing the G20/OECD Principles of Corporate Governance. OECD, G20 and other FSB (Financial Stability Board) members participate in the review, as well as other countries through the Committee's regional Roundtables (Asia, Latin America and the Middle East and North Africa). The overall objective of the review is to update the principles, in light of recent evolutions in capital markets and corporate governance policies and practices. The review was launched in November 2021 and will be completed in 2023.

22.4.6 Kumar Mangalam Birla Committee Report

On May 7, 1999, the Securities and Exchange Board of India (SEBI) appointed a committee headed by Kumar Mangalam Birla. It was formed to promote and raise corporate governance standards. Following are its objectives.

Suggest suitable revisions to the listing agreement implemented by the stock exchanges with the companies and any other measures to enhance the standards of corporate governance in the listed companies in areas such as continuous disclosure of material information, both financial and non-financial, manner and frequency of such disclosures, and responsibilities of independent and outside directors;

Draft a code of corporate best practices; and Suggest safeguards to be instituted within the companies to deal with insider information and insider trading.

The committee identified shareholders, Board of Directors, and the management of a company as the three constituents that play a key role in corporate governance. It tried to identify the roles and responsibilities of each of these constituents in ensuring effective corporate governance. Given here are some of the recommendations givenby the committee.

- The Board should have an optimum combination of executive and non-executive directors and at least 50% of the Board should comprise non-executive directors. At least one-third of the Board should comprise independent directors in case of a non-executive Chairman. At least half of the Board should be independent in case of an executive Chairman.
- A qualified and an independent "Audit Committee" should be set up by the Board of the company. Thus would help enhance the credibility of company's financial disclosure and promote transparency.
- A remuneration committee should be set up by the Board to determine on their behalf and on behalf of the shareholders with agreed terms of

reference, the company's policy on specific remuneration packages for executive directors including pension rights and any compensation payment.

- A committee should be set up by the Board under the Chairmanship of a non-executive/ independent director to specifically look into shareholder issues including share transfer and redressing of shareholder complaints.
- The Board should delegate the power of share transfer to an officer or a committee or to the registrar and share transfer agents in order to expedite the process of share transfers. The delegated authority should attend to share transfer formalities at least once a fortnight.
- The corporate governance section of the annual report should make disclosures on the remuneration paid to the directors in all forms salary, benefits, bonuses, stock options, pension, and other fixed as well as performance linked incentives paid to the directors.
- The Board meetings should be held at least four times a year, with a maximum time gap of four months between any two meetings and all information recommended by the SEBI committee should be placed before the Board.

  As a part of the disclosure related to management, in addition to the directors' report, the management discussion and analysis report should be included in the annual report to the shareholders.
- All company related information like quarterly results and presentations made by the company to analysts may be put on the company's website or may be sent in such a form so as to enable the stock exchange on which the company is listed to put the information on its own website.
- There should be a separate section on corporate governance in the annual report, with details on the level of compliance by the company. Non-compliance of any mandatory recommendations with reasons for it and the extent to which the non- mandatory recommendations have been adopted should be specifically highlighted. The non-executive Chairman of the company should be entitled to maintain an office at the company's expense and also allowed reimbursement of expenses incurred in performance of his/her duties. This will enable him/her to discharge the responsibilities effectively. (This is a non-mandatory recommendation.)
- No director should be a member of more than 10 committees or act as Chairman of more than five committees across all companies in which he/she is a director. Furthermore, it should be a mandatory annual requirement for every director to inform the company about the committee positions he/she occupies in other companies and changes.

- While appointing a new director or re-appointing an existing director, the company should provide a brief resumé of the person detailing his/her expertise in specific functional areas and the names of the companies, in which he/she also holds the directorship and the membership of committees of the Board. These should form part of the notice to shareholders.
- Disclosures to be made to the Board by the management relate to all material, financial, and commercial transactions, where they have personal interest that may have a potential conflict with the interest of the company at large. These include dealings in company shares and commercial dealings with bodies which have shareholding of management and their relatives.
- The half yearly declaration of financial performance, including a summary of the significant events in the last six months, should be sent to each shareholder.
- The financial institutions should under normal circumstances have no direct role in the decision making of the company's Board. They should not have nominees on the Board, merely by virtue of their financial exposure in the company. Term lending financial institutions can have nominees on the Boards of the borrower companies to protect their interests as creditors. In such cases, the nominee directors should play an active part in the Board's activities and assume equalresponsibility with other directors on the Board.
- A separate section on compliance with the mandatory recommendations of Clause 49 should form part of the report and details of non-compliance should be highlighted.
- A certificate from the auditors on compliance should form part of the annual report and annual return, and a copy has to be sent to the stock exchanges.

Other Committees

Post the Kumar Mangalam Committee, other committees were constituted from time to time to bring in revisions and improvements in the corporate governance landscape. Some of the major committees among these are:

a. RBI Report on the Advisory Group on Corporate Governance (2001) – The advisory group was constituted under the chairmanship of R,H,Patil who was the MD of NSE at that time. The group's task was to compare the status of corporate governance in India vis-à-vis the internationally recognised best standards and has suggested a course of action to improve corporate governance standards in India.

b. Naresh Chandra Committee (2002) – Post the corporate debacles that rocked USA and the passing of the Sarbanes Oxley Act, Indian Government constituted the Naresh Committee to recommend changes to the role of independent directors. Some of the recommendations of this committee include:

(a) The minimum board size of all listed companies as well as unlisted public limited companies with paid-up share capital and free reserves of Rs. 100 million and above, or turnover of Rs. 500 million and above, should be seven, of which at least four should be independent directors.

(b) No less than 50% of the board of directors of any listed company as well as unlisted public limited companies with a paid-up share capital and free reserves of Rs. 100 million and above or turnover of Rs. 500 million and above, should consist of independent directors.

c) The audit partners and at least 50% of the engagement team responsible for the audit of either a listed company, or companies whose paid-up capital and free reserves exceeds Rs. 100 million or companies whose turnover exceeds Rs. 500 million, should be rotated every 5 years.

(d) Before agreeing to be appointed (Section 224 (i)(b)), the audit firm must submit a certificate of independence to the audit committee or to the board of directors of the client company.

(e) There should be a certification on compliance of various aspects regarding corporate governance by the CEO and CFO of a listed company.

c. N.R. Narayana Murthy Committee (2003)

This committee was constituted by SEBI under the chairmanship of N.R. Narayana Murthy, chairman and mentor of Infosys. The Committee reviewed the performance of corporate governance in India. Major recommendations are:

(a) Persons should be eligible for the office of non-executive director so long as the term of office did not exceed nine years (in three terms of three years each, running continuously).

(b) The age limit for directors to retire should be decided by companies themselves.

(c) All audit committee members shall be non-executive directors.

d. J.J. Irani Committee (2005)

The committee was constituted by the Government of India to evaluate the comments and suggestions received on ‘concept paper’ and provide recommendations to the Government in making a simplified modern law.

Check Your Progress-2

4. Which of the following committees established to promote and raise the standards of corporate governance has the following objectives?
   i. Draft a code of corporate best practices
   ii. Suggest safeguards to be instituted within the companies to deal with insiderinformation and insider trading
   a. Kumar Mangalam Birla Committee
   b. CII Committee
   c. SEBI
   d. RBI
5. According to the Kumar Mangalam Birla Committee, how many times (at least) in a year should a company hold board meetings?
   a. 4
   b. 3
   c. 2
   d. 1
6. Which of the following reports has to be sent to the shareholders?
   a. Director's report
   b. Management discussions report
   c. Annual report
   d. Quarterly report
7. Which of the following should be sent to stock exchanges, as stipulated by the Kumar Mangalam Birla Report?
   i. Certificate of compliance from an auditor along with the annual report
   ii. Quarterly report
   iii. A brief resume of each member of the board of directors
   iv. Half-yearly report on financial performance
   a. i and ii
   b. i and iii
   c. i and iv
   d. ii and iv
8. Which of the following is not a recommendation made by the CII Committee?
   a. Thirty percent of the members of the board of directors should be non-executive directors, in case of listed companies with a turnover of Rs 1 billion

b. Any member of the board can be the director of more than ten companies if the company has 50% equity stake in those companies

c. Non-executive directors should be paid a commission over and above the sitting fees

d. A director who had not attended even one half of the meetings should not be re-appointed

Example: New Initiatives in Compliance of Corporate Governance
Corporate Governance Report - March 2022

On 21st March 2022, the Company Law Committee (CLC) submitted its third report on corporate governance to the Central Government. This committee was formed by the Ministry of Corporate Affairs (MCA) on 18th September 2019, to recommend changes to foster improved corporate governance, promoted ease of doing business and ease of living to law abiding corporate.

The committee gave recommendations on various key aspects like on Directors' appointment, retirement, etc.; Committees of the board; Reviewing and strengthening the audit framework; Provisions relating to mergers and amalgamations; and changes in other company matters. It also proposed various amendments to the provisions of the Companies Act, 2013 (2013 Act), the Limited Liability Partnership Act, 2008 (LLP Act) and the Rules made thereunder.

Source: https://assets.kpmg/content/dam/kpmg/in/pdf/2022/05/aau-chapter-1-company-law-committee-report-key-proposals.pdf; Dated: May 2022, accessed on 29.07.2022.

22.5 Corporate Governance - Company Law

There has been a sea change in companies Act, 2013 which has waved its way from principle of corporate governance practices as the new key change in the act. The Companies Act, 2013 has taken a foot forward from SEBI's Clause 49 of listing agreement by introducing provisions in the companies act 2013 which promotes corporate governorship code in such a manner that it will no longer be restricted to only listed public companies but also unlisted public companies. Companies Act, 2013 lays greater emphasis on corporate governance as it clearly provides the rules and regulations for the same. Some of the provisions of the Companies Act, 2013 are discussed below:

Board of Directors

Board of directors is the decision making body of any company. It is the duty of the board to comply with all legal rules and regulations. So it is very important that a company constitutes a board of directors as per the provisions of Companies Act, 2103.

Composition of Board- Section 149 of the Companies Act, 2013 provides for appointment of minimum three directors in a public company and two directors in a private company. A board can have a maximum of fifteen directors but can appoint more directors subject to special approval.

Women Director- It is mandatory to appoint a women director in the following classes of company:

- Listed company;
- Public unlisted company having paid-up share capital of one hundred crore rupees or more, or having a turnover of 300 crore or more.

Resident Director- Section 149(3) mandates that every company will have one director who has stayed in India for a period of not less than 182 days.

Independent Director- Independent directors are impartial and bring expertise to the board. They play an important role in resolving conflicts among shareholders and the company. Section 149(6) provides for the qualifications for appointing an independent director in a public company. As per Companies Act, 2013 public listed company shall have at least one-third of directors as independent directors and public unlisted company will have two directors if they meet the following criteria:

- Public companies having a share capital of 10 crore or more;
- Public companies having a turnover of 100 crore or more;
- Public companies having outstanding loans, debentures and deposits of more than 50 crores.

According to section 134 of Companies Act, 2013 the director has to give a detailed financial report which includes the director's responsibility statement. This provision has been enacted to make directors accountable for their actions.

- Stakeholder Relationship Committee

  As per section 178(6) of Companies Act, 2013 if a company has more than one thousand shareholders, debenture-holders, deposit-holders or any other security holders in a financial year then it is mandatory to constitute a stakeholder relationship committee. The main of the committee is to resolve the conflicts between the shareholders and the board of directors and address their grievances. The chairperson of the board shall be a non-executive director.

- Audit Committee

  The Audit Committee looks after the financial reports and disclosures of a company. It is one of the most important components of a corporate governance structure. Under section 177 of Companies Act, 2013 the following class of companies are required to constitute audit committee and they are as follows:

- Listed company
- Public company having a share capital of more than 10 crores;
- Public company having a turnover of Rs. 100 crores;
- Public companies having deposits, outstanding loans or debentures more than 50 crores.
- An audit committee will consist of a minimum of 3 directors and independent directors will form the majority. Section 177(4) provides duties of the audit committee and it has to act in accordance with the same.

Internal Audit

Companies Act, 2013 has mandated the internal audit for certain classes of companies as specified under Section 138 of the Companies Act, 2013.

Serious Fraud Investigation Offence (SFIO)

Section 211 (1) of the Companies Act, 2013 shall establish an office called the Serious Fraud Investigation office to investigate fraud relating to Company. The powers are given to SFIO under the act as mentioned that he can investigate into the affairs of the company or on receipt of report of Registrar or inspector or in the public interest or request from any Department of Central Government or State Government.

- Nomination and Remuneration Committee

  The nomination and remuneration committee decides the selection criteria for the key managerial personnel (KMP) and determines the remuneration of the KMP's and directors. Section 178 of Companies Act, 2013 mandates the constitution of committee for the following class of companies:
- Listed company;
- Public company having a share capital of more than Rs. 10 crores;
- Public company having a turnover of Rs. 100 crores;
- Public company having deposits, outstanding loans or debentures more than Rs.50 crores.
- The nomination and remuneration committee will consist of a minimum of 3 directors and independent directors will form the majority.
- Corporate Social Responsibility

  The concept of CSR rests on the good corporate citizenship where corporate contributions to the societal growth as a part of their corporate responsibility for utilizing the resources of the society for their productive use.

  Ministry of Corporate Affairs[2] has recently notified Section 135 and

[2] *http://www.mca.gov.in/*

Schedule VII of the Companies Act as well as the provisions of (CRS Rules) which has come into effect from 1 April 2014.

Applicability

Section 135 of the Companies Act provides the threshold limit for applicability of the CSR to a Company:

1. Net worth of the company to be Rs 500 crore or more;
2. Turnover of the company to be Rs 1000 crore or more;
3. Net profit of the company to be Rs 5 crore or more.
4. Further, as per the CSR Rules, the provisions of CSR are not only applicable to Indian companies but also applicable to branch offices of a foreign company in India.

CSR Committee and Policy

Every company as prescribed in Section 135 of the Companies Act, 2013 should mandatorily spend at least 2% of its average net profit for the immediately preceding 3 financial years on CSR activities.

Further, the company will be required to constitute a committee (CSR Committee) of the Board of Directors (Board) consisting of 3 or more directors.

The CSR Committee shall formulate and recommend to the Board, a policy which shall indicate the activities to be undertaken (CSR Policy); recommend the amount of expenditure to be incurred on the activities referred and monitor the CSR Policy of the company. The Board shall take into account the recommendations made by the CSR Committee and approve the CSR Policy of the company.

The new CSR regime is based on "Comply or explain" approach to stringently push big corporate giants to take initiative towards their duty to contribute towards their CSR activities. Companies failing to do so would be required to explain why they have not included such information, in the annual report as under Section 92 of the Companies Act, 2013 as part of "comply or explain" approach for large companies.

- **Related Party Transactions**

  A business transaction with relatives of Directors or KMP is considered as Related Party Transactions. It is very important to scrutinize transactions with related parties. Related party transactions are not banned in India and it can be entered by a company. There are certain conditions which need to be fulfilled before entering into a related party transaction as per Section 188 of Companies Act, 2013.

- **Class Action Suits**

  Class action suits allow a group of aggrieved people with the same grievance to file a collective suit against the company. It allows the minority shareholders to file a suit against the company and its management in the National Company Law tribunal (NCLT). Section 245 of Companies Act, 2013 allows suit to be initiated against its directors, management, auditors and any other person who is responsible for fraudulent, unlawful or wrongful act.

22.5.1 Directors - Companies Act, 2013

According to the Companies Act, on incorporation, a company becomes a legal entity. Being a legal entity, it conducts its business with the help of representatives selected by the shareholders. These representatives are known as 'directors'.

According to Section 2(43), the term director means "a director appointed to the Board of a company". To determine whether a person is a director or not, it is important to see if that person is appointed by the company's Articles to act on behalf of the company. A person who performs all the functions of a director, but who has not duly been appointed as one, cannot be considered a director. The Companies Act makes it clear that only an individual can occupy the position of a director and no firm, association, or body corporate can become a director of a company. The Companies Act defines the role and responsibility of directors.

Position of directors

As per Section 153 of Companies Act, 2013, every individual intending to be appointed as director of a company shall make an application for allotment of Director Identification Number to the Central Government in such form and manner and along with such fees as may be prescribed.

The Central Government shall, within one month from the receipt of the application under section 153, allot a Director Identification Number to an applicant in such manner as may be prescribed. Every person or company, while furnishing any return, information or particulars as are required to be furnished under this Act, shall mention the Director Identification Number in such return, information or particulars in case such return, information or particulars relate to the director or contain any reference of any director.

He/she is also required to take up some qualification shares if required by the Articles of Association. According to Section 270, if the Articles require a director to hold some share, he/she must acquire such qualification shares in the company within two months of his/her appointment as a director. When the Articles of a company are altered to increase the qualification shares, the existing directors who have acquired them according to the old norms, do not have to comply with the new norms.

Section 272 lays down that a director who fails to acquire the qualification shares within the specified period of two months will be liable to a fine of up to Rs. 50

per day. Sections 270 and 272 are not applicable to a private company unless it is a subsidiary of a public company (whose shares are traded in stock markets).

Disqualifications of a director

As per Section 164 (1):

1. A person shall not be eligible for appointment as a director of a company, if —

   (a) He is of unsound mind and stands so declared by a competent court;

   (b) He is an undischarged insolvent;

   (c) He has applied to be adjudicated as an insolvent and his application is pending;

   (d) He has been convicted by a court of any offence, whether involving moral turpitude or otherwise, and sentenced in respect thereof to imprisonment for not less than six months and a period of five years has not elapsed from the date of expiry of the sentence: Provided that if a person has been convicted of any offence and sentenced in respect thereof to imprisonment for a period of seven years or more, he shall not be eligible to be appointed as a director in any company;

   (e) An order disqualifying him for appointment as a director has been passed by a court or Tribunal and the order is in force;

   (f) He has not paid any calls in respect of any shares of the company held by him, whether alone or jointly with others, and six months have elapsed from the last day fixed for the payment of the call;

   (g) He has been convicted of the offence dealing with related party transactions under section 188 at any time during the last preceding five years; or

   (h) He has not complied with sub-section (3) of Section 152.

2 No person who is or has been a director of a company which—

   (a) Has not filed financial statements or annual returns for any continuous period of three financial years; or

   (b) Has failed to repay the deposits accepted by it or pay interest thereon or to redeem any debentures on the due date or pay interest due thereon or pay any dividend declared and such failure to pay or redeem continues for one year or more, shall be eligible to be re-appointed as a director of that company or appointed in other company for a period of five years from the date on which the said company fails to do so.

Number of Directors

In accordance with the provisions of Section 149 (1) of the Companies Act, 2013 each company will have at least three directors in the case of a Public Company, two directors in the case of a Private Company, and one Director in the case of a One-Person Company (OPC). A company may appoint fifteen directors, however, a company may exceed the number of directors' more than fifteen directors after a Special Resolution passed at a general company meeting.

According to Section 152(2) of the Companies Act, 2013 every director shall be appointed at the general meeting of the company, unless otherwise is not expressed in this act.

Increasing/decreasing the number of directors: This can be done within the limits stated in the Articles by passing an ordinary resolution. If a company wants to go beyond the limits specified in the Articles, it has to seek the central government's approval to do so.

Powers of Board of Directors

Section 179 of the Act lays down the powers of Board of Directors as follows:

(1) The Board of Directors of a company shall be entitled to exercise all such powers, and to do all such acts and things, as the company is authorised to exercise and do, provided that in exercising such power or doing such act or thing, the Board shall be subject to the provisions contained in that behalf in this Act, or in the memorandum or articles, or in any regulations not inconsistent therewith and duly made thereunder, including regulations made by the company in general meeting

(2) The Board shall not exercise any power or do any act or thing which is directed or required, whether under this Act or by the memorandum or articles of the company or otherwise, to be exercised or done by the company in general meeting.

(3) No regulation made by the company in general meeting shall invalidate any prior act of the Board which would have been valid if that regulation had not been made.

(4) The Board of Directors of a company shall exercise the following powers on behalf of the company by means of resolutions passed at meetings of the Board, namely to:

   (a) Make calls on shareholders in respect of money unpaid on their shares;

   (b) Authorise buy-back of securities under section 68;

   (c) Issue securities, including debentures, whether in or outside India;

   (d) Borrow monies;

(e) Invest the funds of the company;

(f) Grant loans or give guarantee or provide security in respect of loans;

(g) Approve financial statement and the Board's report;

(h) Diversify the business of the company;

(i) Approve amalgamation, merger or reconstruction;

(j) Take over a company or acquire a controlling or substantial stake in another company;

(k) Any other matter which may be prescribed:

Appointment of directors

The directors of a company shall be appointed complying the provisions of the Companies Act 2013 as discussed below:

- As per Section 149 of the Companies Act, 2013 in prescribed class or classes of companies, there should be at least one-woman director. This Section gives who can be appointed as a Director and who cannot be appointed.
- Section 154 of the Companies Act, 2013 requires that every individual intending to be appointed as director should have been allotted DIN (Director Identification Number).
- As per Section 152 of the Companies Act, 2013 the first directors are usually appointed by name in the articles in the manner provided therein.
- According to Section 152(2) every director shall be appointed by the company in general meeting except where the Act provides otherwise. Subsection (6) of the

Section 152 provides that unless the articles provide for the retirement of all directors at every annual general meeting not less than two-thirds of the total number of directors of a public company shall (i) be persons whose period of office is liable to determination by retirement of directors by rotation (ii) be appointed by the company in general meeting except where otherwise expressly provided in this Act. The remaining directors in the case of such a company (i.e., public company) shall in default of and subject to any regulations in the articles of the company also be appointed by the company in general meeting. These provisions do not apply to Government Company and to a subsidiary of a Government company.

- Out of all the Directors, at least one director shall be a person who has stayed in India for a total period of not less than one hundred and eighty-two days in the previous calendar year as per Section 149(3) of the Companies Act, 2013.
- As per Section 149 (1) of the Companies Act, 2013, the maximum limit of

directors in the Company has been increased to 15 with a power to add more directors upon passing of Special Resolution.

- A person cannot become a director in more than 20 companies and out of this 20, he cannot be a director of more than 10 public companies as per Section 165 of the Companies Act, 2013. A transitional period of 1 year is provided to persons acting as director to comply with the requirement of maximum number of directorship and they have to intimate their choice to each of company where they wish to continue as director and also to the Registrar.
- *Independent Directors*- Section 149(4) of the Companies Act, 2013 requires every listed company to have at least one third of the total number of directors as independent directors. The Central Government vide Rule 4 of Companies (Appointment and Qualification of Directors) has prescribed that the following class or classes of Companies shall have at least 2 independent directors-the public company having paid-up share capital of 10 crore rupees or more or the Public companies having turnover of 100 crore rupees or more or the public companies which have an aggregate outstanding loans, debentures and deposits more than 50 crore rupees.
- Section 149 (6) of the Companies Act, 2013 defines independent director elaborately and who can be an independent director.
- Schedule IV of the Companies Act, 2013 has elaborately given the manner of appointment of independent directors, their reappointment, tenure, resignation, removal and separate meetings of the independent directors as well as their evaluation. As per Section 149(10) and (11), term upto 5 consecutive years prospectively but not for more than two consecutive terms, reappointment by special resolution. On holding for two consecutive terms, cooling-off period of 3 years is the prescribed eligibility to become an independent director again.
- Section 149(12) of the Companies Act, 2013 makes an independent director liable only in respect of such acts of omission or commission by a company which had occurred with his knowledge, attributable through board processes, and with his consent or connivance or where he had not acted diligently.
- Act provides provision for limiting the liability of Independent Director and non-executive director not being a promoter or key managerial personnel.
- As per Section 150 of the Companies Act, 2013 an independent director may be selected from a data bank containing names, addresses and qualifications of persons who are eligible and willing to act as independent Directors.
- As per Section 151 of the Companies Act, 2013 a listed company may have one director elected by such small shareholders (holding shares of nominal

value not more than ₹ 20,000) in such a manner and with such terms and conditions as may be prescribed.

- The company and the independent directors shall abide by the provisions of (Code of Conduct) specified in Schedule IV of the Act.
- As per Section 163 of the Companies Act, 2013, a company may provide in its Articles for the appointment of not less than $2/3^{rd}$ of the total directors through the system of proportional representation once in 3 years. Every listed public company shall have at least one-third of the total number of directors as independent directors.
- Section 167 of the Companies Act, 2013 provides for the office of the director becoming vacant on the happening of certain events which is given in subsection (1) of Section 167 such as director becoming disqualified under Section 164, abstains from board meetings for a period of 12 months without seeking leave of absence etc.
- As per Section 168 of the Companies Act, 2013 a director may resign from his office by giving a notice in writing to the company. On receipt of such notice, the board shall take note of the same and the company shall intimate the registrar in such manner within such time and in such form as may be prescribed. The director who submitted resignation is also required to forward a copy of his resignation along with the detailed reasons for his resignation within 30 days to the registrar of companies.
- Section 169 of the Companies Act, 2013 recognizes the inherent right of shareholders to remove the directors appointed by them. It is not even necessary that there should be proof of mismanagement, breach of trust, misfeasance, or other misconduct on the part of the directors. Where the shareholders feel the policies pursued by the directors or any of them are not to their liking, they have the option to remove the directors by passing ordinary resolution. Directors who cannot be removed are – Directors appointed by the tribunal and directors appointed under the system of proportional representation.
- Where an application has been made to the Tribunal under Section 241 against oppression and mismanagement of Company's affairs, the tribunal may order for the termination or setting aside of an agreement which the company might have made with any of its directors.

Duties of a director

The duties of a Director are outlined in Section 166 of the Act. These duties are:

(1) Subject to the provisions of this Act, a director of a company shall act in accordance with the articles of the company.

(2) A director of a company shall 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 for the protection of environment.

(3) A director of a company shall exercise his duties with due and reasonable care, skill and diligence and shall exercise independent judgment.

(4) A director of a company shall not involve in a situation in which he may have a direct or indirect interest that conflicts, or possibly may conflict, with the interest of the company.

(5) A director of a company shall not achieve or attempt to achieve any undue gain or advantage either to himself or to his relatives, partners, or associates and if such director is found guilty of making any undue gain, he shall be liable to pay an amount equal to that gain to the company.

(6) A director of a company shall not assign his office and any assignment so made shall be void.

(7) If a director of the company contravenes the provisions of this section such director shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

Liability of directors

The directors who do not act diligently and honestly are subjected to the following liabilities:

***Unlimited Liability (Section 286)*:** In a limited company, the liability of all or any of the directors or managers may be made unlimited if it is provided under the Companies Act, 2013.

Section 286 speaks about the obligations of directors and managers. Accordingly, the director's liability can be made unlimited at the time of commencement of winding up of the company.

***Liability for Breach of Fiduciary Duty*:** An independent director, being in the fiduciary position of a trustee for the company, may incur liability for breach of his/her fiduciary duty to the company. (Schedule IV of the Companies Act, 2013).

Personal liability of a Director

- For ultra vires acts
- For mala fide acts
- For negligence

Liability to the third parties

Directors are criminally liable in pursuance of the different sections of the Companies Act, 2013.

Some of the important liabilities are:

Section 40 – Failure to comply with respect to securities to be dealt with in stock exchanges

Section 42 – Failure to comply with respect to offer or invitation for subscription of securities on private placement

Section 74 – Failure to comply with respect to repayment of deposits, etc., accepted before the commencement of this Act, 2013

Section 102(5) – Failure to comply with respect to statements to be annexed to notice

Section 127 – Punishment for failure to distribute dividends

Section 129 – Failure to comply with respect to financial statements

Section 137 – Failure to comply with regard to filing of financial statements with the concerned Registrar.

Section 167 – Failure to comply with regard to vacation of office of director

Section 182 – Prohibitions and restrictions regarding political contributions

Section 185 – Failure to comply with regard to loans to directors, etc.

Section 209A – Failure to assist the Registrar or any officer so authorized by the Central Government in inspection of books of account, etc.

Section 305 – False declaration of company's solvency in case of proposal to wind up voluntarily

Section 447 – Punishment for Fraud

Removal of directors

(1) A company may, by ordinary resolution, remove a director, not being a director appointed by the Tribunal under section 242, before the expiry of the period of his office after giving him a reasonable opportunity of being heard: Provided that nothing contained in this sub-section shall apply where the company has availed itself of the option given to it under section 163 to appoint not less than two-thirds of the total number of directors according to the principle of proportional representation.

(2) A special notice shall be required of any resolution, to remove a director under this section, or to appoint somebody in place of a director so removed, at the meeting at which he is removed.

(3) On receipt of notice of a resolution to remove a director under this section, the company shall forthwith send a copy thereof to the director concerned, and the director, whether or not he is a member of the company, shall be entitled to be heard on the resolution at the meeting.

(4) Where notice has been given of a resolution to remove a director under this section and the director concerned makes with respect thereto

representation in writing to the company and requests its notification to members of the company, the company shall, if the time permits it to do so,— (a) in any notice of the resolution given to members of the company, state the fact of the representation having been made; and (b) send a copy of the representation to every member of the company to whom notice of the meeting is sent (whether before or after receipt of the representation by the company)

- The Board of Directors can be removed by the shareholders, the Central Government, or by the Company Law Board.
- Under Section 284, a company can remove a director before the expiry of his/her period of office by passing an ordinary resolution.
- Under Sections 388B and 388E, the Central Government can remove a director on the recommendation of the Company Law Board.
- The Company Law Board can terminate the services of a Director when it receives an application for his/her removal due to mismanagement.

Remuneration of directors

The 2013 Act brought many changes to the existing guidelines related to appointment and remuneration of managerial personnel. The provisions for appointment of managing director, whole time director or manager are applicable to all companies. The overall ceiling in respect of payment of managerial remuneration by a public company remains at 11% of the profit for the financial year computed in the manner laid down in the 2013 Act.

- Independent director not entitled to stock option and may receive remuneration only by way of fees or commission.
- There is no specific provision in the Companies Act, 2013 suggesting that directors must be paid remuneration for their services. However, Section 197(5) and (6) lay down the manner of payment of remuneration to a director and the limits thereto. Section 197 deals with overall maximum managerial remuneration. Schedule V deals with payment of remuneration to managerial personnel obviating requirement of the approval of the Central Government.
- Where a company is required to re-state its financial statement due to fraud or non-compliance with any requirement under this Act and the rules made thereunder, the company shall recover from any past or present managing director or whole-time director or manager who, during the period for which the financial statements are required to be re-stated, the remuneration received (including stock option) arisen due to such statement or non-compliance in excess of what would have been paid to the managing director, whole-time director or manager under such re-stated financial statements as per Section 199 of the Companies Act, 2013.

- Every company belonging to such class or description of companies as may be prescribed shall have a Managing Director, or Chief Executive Officer or Manager and in their absence, a whole-time director, and Company Secretary. An individual shall not be appointed or reappointed as the chairperson of the company, in pursuance of the articles of the company, as well as the managing director or Chief Executive Officer of the company at the same time after the date of commencement of this Act unless, — the articles of such a company provide otherwise; or the company does not carry multiple businesses as per Section 203 of the Companies Act, 2013.
- Secretarial Audit compliance report in case of certain class of companies to be annexed with the Board's report as per Section 204 of the Companies Act, 2013.

Managing director

Section 2(54) of the Companies Act defines a managing director as — a director who, by virtue of the articles of a company or an agreement with the company or a resolution passed in its general meeting, or by its Board of Directors, is entrusted with substantial powers of management of the affairs of the company and includes a director occupying the position of managing director, by whatever name called.

Appointment of Managing Director: A managing director can be appointed in one of the following ways -- by virtue of an agreement with the company; by virtue of a resolution passed by the Board of Directors, and by virtue of the Memorandum/Articles of Association. To be appointed as Managing Director, the person should not be:

(a) Below the age of twenty-one years or has attained the age of seventy years: Provided that appointment of a person who has attained the age of seventy years may be made by passing a special resolution in which case the explanatory statement annexed to the notice for such motion shall indicate the justification for appointing such person;

(b) An undischarged insolvent or has at any time been adjudged as an insolvent;

(c) Has at any time suspended payment to his creditors or makes, or has at any time made, a composition with them; or

(d) Has at any time been convicted by a court of an offence and sentenced for a period of more than six months.

Remuneration of Managing Director: The total managerial remuneration payable by a public company, to its directors, including managing director and whole-time director, and its manager in respect of any financial year shall not exceed eleven per cent. of the net profits of that company for that financial year computed in the manner laid down in section 198 except that the remuneration of the directors shall not be deducted from the gross profits.

Provided further that, except with the approval of the company in general meeting,—

(i) The remuneration payable to any one managing director; or whole-time director or manager shall not exceed five per cent. of the net profits of the company and if there is more than one such 123 director remuneration shall not exceed ten per cent. of the net profits to all such directors and manager taken together;

(ii) The remuneration payable to directors who are neither managing directors nor whole-time directors shall not exceed, —

(A) One per cent of the net profits of the company, if there is a managing or whole-time director or manager;

(B) Three per cent of the net profits in any other case.

Resignation of the Managing Director: A managing director can resign from his/her post. However, the resignation will come into effect only when the company approves it. After resigning, the managing director can still continue as an ordinary director.

Number of Companies: An individual can act as the managing director of any number of private companies that are not subsidiaries of a public company. If a person acts as the managing director of a private company which is a subsidiary of a public company, he/she can take up the managing director post of only one other company.

Tenure of Appointment: According to Section 317, the managing director of a public company or a private company, which is a subsidiary of a public company, can be appointed for a period of not more than 5 years. He/she can be reappointed for another five years on completion of his/her term.

Check Your Progress-3

9 According to the Companies Act, 1956, how many directors can a public limitedcompany have?
a. 1
b. 2
c. 3
d. 4

10. When the Board of directors ______________________, it is exercising its power on behalf of the company.
i. Invest funds, give loans, issue debentures, and borrow money
ii. Fill vacancies in the board, appoint the managing director
iii. Contribute to charities that are not directly related to the business
iv. Sell a subsidiary which is making losses

a. i and ii
b. ii and iii
c. i, ii and iii
d. i, iii and iv

11. Which of the following is a statutory duty of the director?
    a. To act honestly and with utmost good faith
    b. To act with the best skills and expertise
    c. To reveal his financial interests in a contract, if any to the board
    d. To convene the annual general meeting

12. Which of the following liabilities can be assumed by directors?
    i. Liability for the losses incurred by the company as a result of the directors'

       negligence in discharging of their duties
    ii. Liability for breach of fiduciary duty towards the company
    iii. Criminal liability for fraudulently inducing people to invest money in thecompany

    a. Only i and ii
    b. Only i and iii
    c. Only ii and iii
    d. i, ii, and iii

13. Which of the following is not true about the selection of a managing director?
    a. He can be appointed by a committee, which consists of the CEO and theChairman.
    b. He can be appointed by virtue of an agreement with the company.
    c. He can be appointed by virtue of a resolution passed by the board of directors.
    d. He can be appointed by virtue of a company's Memorandum of Association.

14. Which of the following facts concerning the remuneration of the managing director is correct?
    a. He can be paid 4% of the net profit
    b. He can be paid 10% of the net profit
    c. He can be paid 5% of the net profit
    d. He can be paid 15% of the net profit

15. Which of the following statements regarding the resignation of the managing director is not true?
    i. The resignation is accepted only when the company approves it.
    ii. After resignation, he can act as an ordinary director.

iii. After resignation, he loses his primary membership of the Board of Directors.
iv. The resignation is accepted only when he finds someone to take his place.
a. i and ii
b. i and iii
c. ii and iii
d. iii and iv

16. What is the tenure of a managing director?
    a. Not more than 3 years
    b. Not more than 5 years
    c. Not more than 7 years
    d. Not more than 10 years

17. A director can be removed ___________________________.
    a. By passing an ordinary resolution
    b. If a majority of the board members vote against him
    c. By using the chairman's right to remove the director
    d. Only when non-executive members accept the proposal

Example: CLC Recommendations for Better Corporate Governance

Ministry of Corporate Affairs (MCA) formed CLC (Company Law Committee) submitted its third report on corporate governance and ease of doing business by corporates on March 2022. It sought certain amendments to the provisions of the Companies Act, 2013.

Some of such amendments were-

- Allowing certain companies to revert to the financial year followed in India;
- Facilitating certain companies to communicate with their members in only electronic form;
- Recognising issuance and holding of fractional shares, Restricted Stock Units and Stock Appreciation Rights;
- Easing the requirement of raising capital in distressed companies;
- Replacing the requirement of furnishing affidavits with the filing of self-certification/ declaration;
- Clarifying the inclusion of 'free reserves' while determining the limit for buying back of a company's equity shares;
- Prohibiting companies from recording trusts on their register of members;

Contd. ....

- Allowing companies to hold general meetings in virtual, physical or hybrid modes;
- Creating an electronic platform for maintenance of statutory registers by companies;
- Clarifying provisions relating to Investor Education and Protection Fund;
- Strengthening the National Financial Reporting Authority;
- Reviewing and strengthening the audit framework and introducing mechanisms to ensure the independence of auditors;
- Standardising the manner for auditors to provide qualifications;
- Recognising and providing an enabling framework for the constitution of Risk Management Committees;
- Clarifying the tenure of independent directors;
- Revising provisions relating to the disqualification and vacation of the office of directors;
- Clarifying the procedure for the resignation of key managerial personnel;
- Strengthening the provisions relating to mergers and amalgamations;
- Easing the restoration of struck off companies by enabling the Regional Director to allow restoration of names of companies in certain instances;
- Recognising Special Purpose Acquisition Companies and allowing such companies, which are incorporated in India, to list on permitted exchanges;
- Prohibiting the conversion of co-operative societies into a company;
- Modernising enforcement and adjudication activities through electronic mode; Strengthening the incorporation and governance framework for Nidhis;
- Removing ambiguities from present provisions under the Companies Act, 2013 through changes of drafting & consequential nature.

Source: https://www.mca.gov.in/bin/dms/getdocument?mds=bwsK%252FBEAFTVdpdKuv5IR5w%253D%253D&type=open, dated: March 2022; Accessed on 29.07.2022

Activity: Of late, the remuneration of directors has become a controversial issue. Discuss the norms framed by different committees with regard to the remuneration of the directors? Discuss examples of few companies that have landed into trouble after paying huge remuneration to its directors.

Answer:

____

____

____

22.6 Summary

- Codes and regulations are sets of rules, or principles, or standards that are intended to control, guide, or manage behavior or the conduct of individuals working in organizations, the basic difference between the two being that codes are self-imposed or self-regulated, while regulations are official, i.e., imposed by the State.
- Codes are generally self-regulatory for guiding conduct or behavior. They do not involve some official authority directing or controlling behavior.
- Losses suffered by investors and lenders in the recent past (throughout the world) have raised concerns about the standards of financial reporting and accountability of management.
- Many believed that these losses could have been avoided if companies had had transparent reporting practices and good corporate governance.
- In recent years, governments and corporates have made sincere efforts to design corporate codes to govern the functioning of corporations.
- The important corporate governance reports published in India and abroad are the Cadbury Committee report, the CII Committee report, the OECD report, and the Kumar Mangalam Birla Committee s report.
- The Companies Act, 2013, and the various amendments to the Act in later years have also described the code of best practices for ensuring better corporate governance.
- The Companies Act has provisions with regard to Board meetings being held at regular intervals, the Board of Directors disclosing interests in dealings with the company that may result in conflict of interest, maintenance of books of accounts, audit, auditors' report, directors' report etc.

22.7 Glossary

Code: A code is a set of rules, which are accepted as general principles, which state how people in a particular organization or country should behave.

22.8 Self-Assessment Test

1. What is a code of corporate governance? Do you think such a code can improve the corporate governance mechanism in organizations?
2. Discuss the codes of corporate governance laid down by the Kumara Mangalam Birla Committee.
3. The Confederation of Indian Industry (CII) drafted a code of corporate governance for Indian companies to compete efficiently in the global market place. Discuss the code of conduct for corporate governance as recommended by the CII.

4. What is the difference between a code and a regulation? List out the benefits of aself-regulatory code.

5. Discuss briefly the rights of shareholders, as mentioned in the OECD Report oncorporate governance.

6. Codes are self-regulatory rules for guiding the conduct or behavior of an individual. What are the benefits of self-regulation?

22.9 Suggested Readings / Reference Material

1. K P Muraleedharan, E K Satheesh (2022). Fernando's Business Ethics and Corporate Governance, Pearson India. 3rd edition
2. Manuel G. Velasquez (2021). Business Ethics – Concepts and Cases. Pearson Education, 8th edition
3. K Viyyanna Rao & G Naga Raju (2020). Business Ethics and Corporate Governance. 1st edition. Wiley
4. Jyotsna GB & RC Joshi (2020). Business Ethics and Corporate Governance. McGraw Hill India. 1st edition
5. Sandeep Goel (2020). Corporate Governance. McGraw Hill India. 1st edition

22.10 Answers to Check Your Progress Questions

1. (d) Codes

Codes and regulations are sets of rules, principles, or standards that are intended to control, guide, or manage behavior or the conduct of individuals working in organizations.

2. (b) Corporate governance

The CII committee report, the Cadbury Committee report, and the OECD report address issues related to corporate governance.

3. (d) The directors can have financial interests in the company

All statements are true regarding the recommendations of the Cadbury Committee, except statement (d). A majority of directors should be independent non-executive directors. They should not have any financial interests in the company.

4. (a) Kumar Mangalam Birla Committee

The Kumar Mangalam Birla committee was formed to promote and raise corporate governance standards.

5. (a) 4

According to the Kumar Mangalam Birla Committee, board meetings should be held at least four times a year. (b) Financial institutions can recommend their nominees to the board by virtue of their financial exposure in the company.

All the given options regarding the Kumar Mangalam Birla Committee recommendations are true, except option (b). The financial institutions should under normal circumstances have no direct role in the decision making of the company's Board. They should not have nominees on the Board, merely by virtue of their financial exposure in the company.

6. (c) Annual report

The annual reports have to be sent to the shareholders. The other reports like director's report, management discussions report, and the quarterly report are not given to the shareholders.

7. (a) i and ii

Options i and ii are true regarding the documents to be sent to the stock exchanges, as recommended by the Kumar Mangalam Committee. A certificate from the auditors on compliance should form part of the annual report and annual return, and a copy has to be sent to the stock exchanges. All company related information like quarterly results and presentations made by the company to analysts may be put on the company's website or may be sent in such a form so as to enable the stock exchange on which the company is listed to put the information on its own website.

8. (b) Any member of the board can be the director of more than ten companies if the company has 50% equity stake in those companies.

All the options are the recommendations of the CII Committee, except option (b). No single person should hold directorships in more than ten companies. This ceiling excludes directorships in subsidiaries (where the group has over a 50% equity stake) or associate companies (where the group has over 25% but no more than a 50% equity stake).

9. (c) 3

According to the Companies Act, 1956, there should be at least three directors ina public limited company, while other companies should have at least two directors.

10. (a) i and ii

The powers that can be exercised by the Board of Directors on behalf of the company include power to make calls on shareholders in respect of money unpaid on their shares; powers to issue debentures; power to borrow money otherwise than on debentures, from the RBI, the State Bank of India, or any other banks established by or under any Act; power to invest the funds of the company; power to grant loans; power to fill up casual vacancies in the Board; power to sanction a contract in which he/she is interested; power to recommend the rate of dividend to be declared by the company at the Annual General Meeting, subject to the shareholders' approval; power to appoint a person as a managing director or a manager who is holding either office in another company; and power to invest in any share of any other company.

11. (c) To reveal his financial interests in a contract, if any to the board

Following are the statutory duties of a director --- a director of a firm should not enter into a contract with a company (belonging to his/her relatives) for sale; he/she should not purchase or sell any goods unless it is with the consent of the Board of Directors; companies having Rs. 10 million or more should not enter into a contract with companies having a connection to its directors without the prior approval of the central government; and all directors should reveal their financial interests, if any, to the Board.

12. (d) i, ii, and iii

Directors who fail to carry out their duties diligently and honestly are subject tothe unlimited liability, liability for breach of fiduciary duty, personal liabilities, and criminal liabilities. All the options are true regarding the liabilities that can be assumed by directors.

13. (a) He can be appointed by a committee, which consists of the CEO and the Chairman.

A managing director can be appointed in one of the following ways -- by virtue of an agreement with the company; by virtue of a resolution passed by the Board of Directors, and by virtue of the Memorandum/Articles of Association.

14. (c) He can be paid 5% of the net profits

The remuneration of a managing director should not exceed 5% of the company's net profits. If there is more than one director; the aggregate remuneration can beup to 10% as per Section 309(3).

15. (d) iii and iv

Options iii and iv are true regarding the resignation of the managing director. A managing director can resign from his/her post. The resignation will come into effect only when the company approves it. After resigning, the managing director can still continue as an ordinary director.

16. (b) Not more than 5 years

According to Section 317, the managing director of a public company or a private company, which is a subsidiary of a public company, can be appointed for a period of not more than 5 years. He/she can be reappointed for another five years on completion of his/her term.

17. (a) By passing an ordinary resolution

The shareholders, the central government, or the Company Law Board can remove the Board of Directors. Under Section 284, a company can remove a director before the expiry of his/her period of office by passing an ordinary resolution.

Business Ethics and Corporate Governance

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