



CORPORATE GOVERNANCE (AN ANALYSIS OF SEBI CLAUSE 49)

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INTRODUCTION

Several frauds and scandals have surfaced in the corporate world in recent days.

Corporate Corruption and frauds in India

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| 1. Non-banking <u>finace</u> companies scam (1995-97) | About Rs50,000 crore were raised from <u>high</u> return seeking investors by the <u>companies</u> which vanished. |
| 2. Unit Trust of India's <u>two</u> episodes 2001 | When Mr. <u>Pherwani</u> was chairman
When Mr. <u>Subramaniam</u> was chairman |
| 3. Ketan Pareekh's fraud in 2002 | Involving bank of India & Gujarat Cooperative bank |
| 4. Global Trust Bank (2002-03) | Audited accounts showed profit of Rs 40 <u>crore</u> while RBI inspection report revealed <u>negative</u> net worth. The bank was forced to <u>merge</u> with Oriental bank of Commerce. It was a case of mismanagement of bank assets for <u>personal</u> gains by the top officials, fraudulent <u>financial</u> reporting, and a failure on the part of <u>statutory</u> auditor (Rs 13,000 crore were involved) |
| 5. <u>Telgi's</u> stamp paper Scam 2004 | |
| 6. Satyam Computers 2008 | |

In order to check the scandals & frauds in corporate sector & to improve the system of corporate world the following committees were appointed to develop corporate governance codes.

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IMPORTANT CORPORATE GOVERNANCE CODES FOR GOOD CORPORATE GOVERNANCE

Committee/Legislation

1. Kumar Mangalam Birla committee (1998) set up by SEBI, (Guidelines on corporate governance 16 points).
2. Amendment of the companies act, 1998 and 2000.
3. Clause-49 of the listing agreement under SEBI act, 1992.
4. Naresh Chandra Committee (2002) set by the department of the company affairs (DCA), govt. of India.
5. Narayan Murti Committee (2003) set up by the SEBI.
6. J.J. Irani Committee (2004) set up by the govt. of India.
7. (New) clause-49 of the listing agreement (2004)

Achievement

1. Its comprehensive recommendation was comprised of two parts Mandatory requirements and Non-mandatory requirements.
2. Several important provisions were legislated to improve the transparency and accountability of corporate in India.
3. The SEBI introduced clause 49 of the listing agreement through the stock exchange in India for compliance of the listing companies. It was based on several of the recommendations of the Kumar Mangalam Birla Committee.
4. It emphasized corporate audit and governance role issues. Many recommendations of the committee were incorporated in the company's bill, 2003.
5. The committee reviewed the performance of corporate governance in the country, the role of companies in responding to rumor and other price sensitive market information to enhance the transparency and integrity of the market. On many matters the committee concurred with the Naresh Chandra Committee. It made two sets of recommendations-mandatory and non mandatory.
6. The committee evaluated structurally the views of several stakeholders in revamping the companies act in India. Many of its recommendations have found place in the company's Amendment bill, 2005, it well, if enacted, go a long way in achieving sustainable corporate growth.



7. SEBI's circular on listing agreement was used by the stock exchange to revise clause 49 to make its provisions internationally competitive for raising the standards practices among listed companies in India.

Background

1. SEBI set up this committee to promote and raise standards of corporate governance in India.
2. Prevailing corporate environment in the world motivated the govt. to take such measures.
3. Raising the standard of governance practices among listed companies was the main objective to the capital market regulator.
4. The enactment of Sarbanes- Oxley act, 2002, in the USA and concerns about the corporate governance practices prompted the govt. to set up the committee.
5. SEBI's concern to expeditiously promote the effectiveness of corporate governance practices in idea and protect the interest of the investors prompted setting up of this committee.
6. Revamping the companies act, 1956 is long overdue. Successive govt. made abortive to restructure the companies act bill, 1997, companies bill, 2002 and 2005.
7. Many of the provisions of the revised clause were derived from Sarbanes Oxley act (2002) of the USA.

OBJECTIVES OF THE STUDY

The objective of the study is to examine that whether clause 49 introduced by S.E.B.I. for listed companies is complied by listed companies or not. In that clause 49 most important provision is composition of the board of directors. There must be balance between executive directors and non-executive directors/independent directors in the board of management.

REVIEW OF LITERATURE

There are four Pillars of wisdom

1. Nomination committee
2. Remuneration committee
3. Audit committee (Mandatory)
4. Shareholders Grievance committee (Mandatory)



Clause -49 prescribes only two committee as mandatory.

Nomination Committee: Kumar Mangalam Birla Committee has recommended a board with at least fifty percent independent directors if the chairman is an executive, and alternatively, a board with at least one third independent directors if the chairman is non-executive.

For constituting a balanced board, it is important to constitute a Nomination committee comprising of three to five outstanding personalities. This committee should be formed inviting nominations from the ordinary shareholders (excluding the top ten Shareholders) through postal ballot. To facilitate easy nomination, the full group of non-executive directors should shortlist a panel. The nomination committee should advise shareholders in the matter of nomination of independent directors. The nomination report of the nomination committee should be placed in the general meeting of the company the chairman of the committee. Unless the process of nomination of independent directors becomes independent and free from the opinion of the board, it is difficult to achieve the targeted balanced board. If the nomination committee is not in place, it is difficult to ensure nomination of independent directors.

Remuneration Committee: Clause-49 says that there should be a remuneration committee consisting of three member and its chairman should be ID. This committee will see that whether recommendation paid to IDs are accordance with schedule XIII of the companies act 1956. This committee is not mandatory.

Audit Committee: The only pillar that has been viewed in the Indian corporate governance code is the establishment of an independent and qualified audit committee.

Provisions of Audit Committee

(Under section 292 A of the Company act, 1956)

1. The committee shall have at least three member directors.
2. Two third of the member shall be non-executive directors/independent directors.
3. The board of directors shall prescribe the committee's terms of reference in writing.
4. The statutory auditor, the internal auditor and director in-charge of finance shall attend every meeting of the audit committee but shall not have the right to vote.
5. The audit committee should discuss half yearly and annual accounts with auditors before presenting the same to the board.



6. The audit committee shall have right to investigate any matter covered under the board terms of reference.
7. The chairman of the audit committee shall attend the annual general meeting to provide clarifications on matters relating to audit.
8. The constitution and composition of the audit committee is to be disclosed in the annual report of the company.
9. Audit committee should discuss internal control, scope of audit, observations of auditors, review of periodic financial statements etc. and compliance of internal control system.
10. The minutes of the audit committee are required to be placed before the next board meeting.

Shareholder's Grievance Committee: It is mandatory. In this committee there should be three member and it's chairman should be independent director. This committee will solve the problems and grievances of the share holders.

Evaluation of IDs Institutions

- Some people say that ID is to protect the interest of shareholders. Other says its role is to protect the interest of minority shareholders, some says that its duty is to protect the interest of stakeholders. This objective can be achieved by opposing ideas that are detrimental to their interest and establishing financial control, to ensure that Promoters/Management do not enrich themselves through unfair means. The actual meaning of independent directors is that he should be independent of the Promoters/Management. The independence of mind must be there. When clause-49 was introduced by SEBI for corporate sector, it was thought that it will control the frauds & will serve the interest of minority shareholders but Satyam case has vindicated us. There are 2500 + listed companies which are governed by clause-49 of listing agreement. Only very few companies like Infosys, Tata's Godrej, HDFC, Hero Honda are completely following corporate governance practices, but they are only show pieces of the total companies.
- In actual practice the promoter identifies a person, puts his name before the company's nomination committee. Nomination committee blindly approves the name. The name is then taken to annual general meeting & AGM also approve the



same name. Committee has been rejected by AGM. The procedure for appointing ID seems to be hollow. When it was made compulsory to appoint ID on the board upto 31 dec. 2005. The companies have appointed 30,000 ID on their Boards. In some cases they have redesignated their executive directors as IDs. There number was 3000. How can we accept such persons to suddenly reverse their roles and become independent. To solve this problem there should be a pool of professionals of outstanding merit.

- ID can be grouped in three categories; home director; value director; and celebrity director.

Home Director: In this category those ID are included, who are known personally to the promoters, like relatives, friends, neighbors, ex-employees, ex-teachers. Since there is no qualifications laid down for IDs every one who is above the age of 21 years is qualified to become an ID that means over 60 crore Indian are eligible to become IDs. Since there is no prescribed format & qualifications for becoming IDs, sometimes even family members or friends can be appointed as IDs because they are known to Promoters/Management.

Value Director: In this category we include those IDs brings knowledge and expertise in the company. Examples of such IDs may include lawyers, finance professionals, technocrats, retired civil servants, etc. Persons in this category are also appointed, who are either personally know to the promoters or have been referred by some one close to the promoters. They are also highly paid. They are the persons who can highlight the wrong doings of the Promoters/Management. It is observed that by and large they also support the Promoters/Management. There are number of cases in board room meetings where value director remained calm & quiet when promoters were taking such decisions in meeting to enrich them on the cost of minority shareholders like preferential issue of warrants, mergers & amalgamation of group companies, managerial remuneration etc. IRS could be better, due to their understanding of corporate finance. During their service tenure they might have come across number of frauds & scam done by the corporate sector. But such IDs are not preferred by management. In this category of value director only 15 of the total director are there.

Celebrity Director: People in this category are invited because they are of super star in their area. The category includes film stars, lyricists, sportsman, chief of armed forces, fiction



writers etc. Directors in this category are of high integrity but they are knowing nothing about corporate system; hence neither they will help to the company nor harm.

Promoters/Management is happy with such persons because they will not speak any words against management if some policies are going wrong in the board meetings. Only 5% of total IDs fall in this category.

- Since most of the ID's are not well qualified and well versed with company accounting and financial procedure, they fail to locate any fraud or misappropriation done by promoters/Management. It is a well established fact that promoters are very intelligent persons because they are siphoning off the huge money from the public and using the way they like. Under these circumstances it is very difficult to check these promoters by the IDs.
- Many Studies shows that out of 3000 listed companies & large number of IDs on the board, IDs have not given note of dissent on any issue.
- The Companies Act 1956 says that one can be a director of 15 public companies. It is observed that hundred of individuals who hold directorship in a large number of companies. Director data base reveals that as many as 330 individuals holds 5 or more than 5 directorship positions in listed companies and in addition, directorship of several unlisted companies.
- SEBI has now prescribed 180 days for filling vacancies of the IDs. Which is very long period. There are a total of 6443 individuals serving as IDs on the board of 2213 listed companies. Many companies have too few directors, while some have too many. As many as 21% of the companies have just 1 or 2 IDs.
- Since board meetings are held after four months, huge agenda items are put in the meeting. The agenda is often sent very late to the directors so that they cannot come prepared. Some proposals are put as a table item. Minutes of the meetings are sent very late. Sometimes it is given in the beginning of the meeting. As such IDs cannot effectively deliberate on the issues.
- Since IDs have no control over company affairs they should not be responsible for every wrong in the company. IDs need to be accountable for decisions that they were a party too. Negligence should also be treated as connivance.



- Clause-49 is not followed strictly in companies. There is no proper system of information in companies to the stock exchange. The SEBI is also not very serious about compliance. No action has yet been taken against the non compliant companies.

SUGGESTIONS

- Tenure of IDs should be fixed. It is suggested that IDs should compulsorily retire after six years from the board of directors.
- There should be corporate governance rating:- The Credit rating agencies should rate the company on the following aspects: Quality of board members; knowledge of IDs of company or industry; The attendance records; Quality of agenda items; Minutes of the meetings; and Other board room practices.

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