

Corporate governance undergoing major review



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Corporate governance is the acceptance by a company's management of the inalienable rights of the shareholders as the true owners of the company and of the management's role as trustees on behalf of the shareholders. In essence, corporate governance is about commitment to values, ethical business conduct and distinguishing between personal and corporate funds in the management of the company.

The basic framework for regulation of all companies in India is contained in the Companies Act, 1956, which provides for checks and balances over the powers of the board. In addition, under the Securities Contracts (Regulation) Act, 1956, every listed company in India needs to comply with the Equity Listing Agreement.

Clause 49

Considering the emergence of codes of best corporate governance practices all over the world and to promote and raise the standard of corporate governance in India, in February 2000 the Securities and Exchange Board of India (SEBI) inserted a new clause in the Equity Listing Agreement, i.e. clause 49.

It is noteworthy that India's corporate governance framework complies with the OECD Principles of Corporate Governance, which have become an international benchmark for policymakers, investors, corporations and other stakeholders worldwide.

Clause 49 of the listing agreement has been the mainstay of corporate governance in India for more than a decade. Although such norms are expected to keep pace with ever-changing corporate scenario, the previous detailed review of clause 49 was back in 2004 and revised norms came into effect in January 2006.

Recent proposals

Since then, most of the changes and proposals have come from the central government. Notable among them are the Ministry of Corporate Affairs' voluntary guidelines of 2009, and substantial insertions on corporate governance issues in the Companies Bill, 2012, which has been approved by the Lok Sabha and is awaiting consideration by the Rajya Sabha.

This January SEBI issued a consultative paper proposing tougher guidelines for listed companies. Comments were due by the end of January. SEBI's proposals seek to bring clause 49 into line with the proposals made in the Companies Bill, and to impose a more stringent regime for listed companies.

The consultative paper proposes 26 principles of corporate governance, which would be incorporated in the listing agreement and would override any other rules of corporate governance. Non-mandatory provisions under the existing regime would be done away with.

While the present governance norms in India have been inspired from Western jurisdictions where concentration of shareholding is rare, the popular corporate structure in India involves controlling shareholders. Several proposals have been made to address this issue, such as minority shareholder participation in the election of independent directors, detailed procedures for related-party transactions, and boards that reflect diversity of experience, knowledge, perspective, gender and age.

The consultative paper suggests that independent directors be appointed by minority shareholders. Such directors should be formally trained to be on a company board and regularly evaluated for their performance.

To avoid concentration of power in

one person's hands, the regulator has proposed separating the position of chairman from that of managing director in a company. The paper also suggests measures such as rationalizing CEO pay packets, improving compliance for the benefit of small investors, making whistle-blower mechanisms compulsory, and implementing orderly succession planning. To strengthen the monitoring of compliance, SEBI has suggested that credit rating agencies carry out corporate governance rating, and that stock exchanges/SEBI conduct inspections to verify compliance.

What lies ahead?

Since substantial aspects of corporate governance have been covered in the Companies Bill, there is concern that another full-scale revision of the corporate governance rules by SEBI along with 26 principles of corporate governance may create multiplicity in the regulatory process and inconsistency among different sets of regulations.

The final outcome of the revision of the corporate governance regime will be known only after the Companies Bill is passed by the Rajya Sabha and the results of SEBI's consultative paper are released. However, the proposals, if implemented, would surely bring Indian corporate governance norms up to the highest global standards and make Indian companies more transparent and accountable.

Ranjana Roy Gawai, the managing partner at RRG & Associates, participated in the round-table consultation on SEBI's consultative paper to review corporate governance norms in India, organized by the Indian Institute of Corporate Affairs, Ministry of Corporate Affairs. Vasudha Sen is a team leader at RRG & Associates.