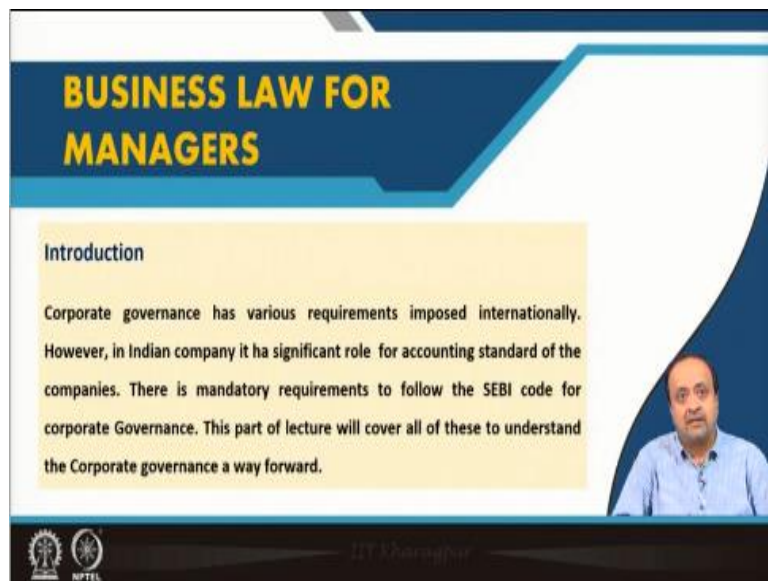


Business Law for Managers
Mr. Kaushik Mukherjee
Vinod Gupta School of Management
Indian Institute of Technology, Kharagpur
Module-2: Corporate Governance
Lecture – 10
Corporate Governance a Way Forward

Good evening. Model 2, lecture 10 Corporate Governance a way forward.
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Corporate governance is always a way forward. It is something of a journey for any organisation, for any corporate or a wider thing for a corporate organisation for any country. There is literally no end to this journey. And in case of India also, we have come a long way from the days of voting at remote places for annual general meeting, where the shareholders cannot go, just because the shareholders cannot go, you have your registered office.

And remotest of remote part of the country were hardly out of total 50,000 shareholders in a company, 50 shareholders even cannot reach and out of which 49 belongs to a particular majority shareholders and maybe 1 or 2 straight shareholders living nearby can approach and all decisions passed within minutes, because shareholders cannot reach there. This was the practice in India.

Even 10 years back, have your registered office at the remotest place? So, that annual general meeting, the only meeting where shareholders can participate and take a performance

appraisal of the management, the owners who are in control of the management, including the directors, the auditors, statutory auditors cannot even reach that place. And votes are only cast those who could reach.

So, out of 10,000, 50,000 shareholders only 50 shareholders, 100 shareholders used to come, vote and all resolutions got passed in 5 to 10 minutes. Today, even in the remotest place, if a shareholder is there, he can if he wishes too that is a different concept, whether he wishes or not, but today he has the option to vote for or against a resolution; exercises is your choice.

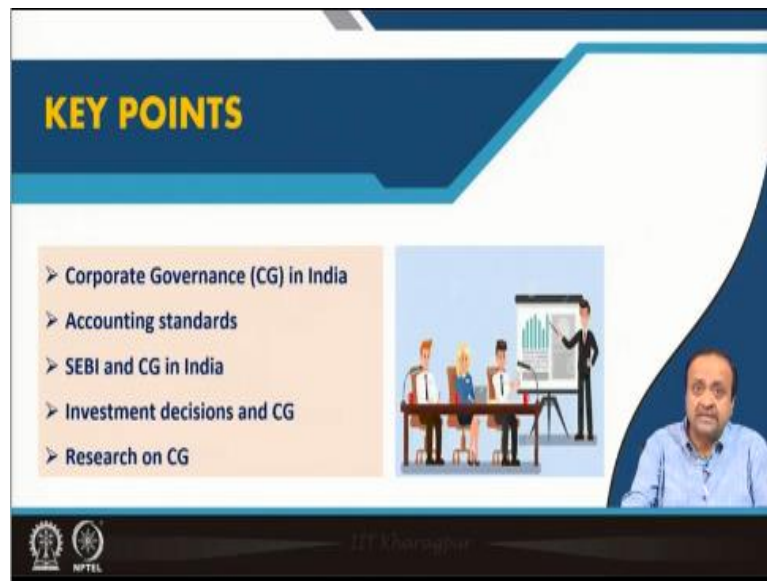
And therefore, today, we are hearing and we are seeing literally resolution of resolution supported by the majority shareholders are getting defeated in the hands of the minority shareholders. Why is it happening? Because, you have allowed them to vote. You have done a mechanism of voting which is e-voting, electronic voting because you have made them aware by the various disclosures as you have done in the stock exchanges, which everybody is privy.

Everybody can see in the public domain. Because, you have brought out results in 3 months which used to come out in 1 year. Now, in 3 months, you are getting the results of a company; every quarter, you are finding what the company is doing. Because you have been built in a system of monitoring by independent directors, audit committees, risk management committees, various committees you have created of the board largely of directors who are not connected with the promoter shareholders, large shareholders.

All these have enabled the investors to be a little aware of still a long, long way to go but today still, with this small progress, we can see the results coming. Not one, quite a few. Resolutions supported by majority shareholders even holding 60% shares getting defeated even to the extent of shareholders, resolutions proposed by management supported resolutions proposed by majority shareholders sent to the shareholders for approval.

Withdrawn, withdrawn taken back, knowing fully well that this will get defeated, but at the same time of sending, they were not aware. In 10 days, 15 days, they came to know that these resolutions will get defeated, but by that time, the field has come from the market that the overall feeling is, this resolution does not require to be supported. So, a long way has, we have come in this journey of corporate governance.

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The way forward is going to be very interesting. It is to be seen how the majority shareholder run companies discipline themselves. Yes, there are quite a few of them who are doing everything possible to do the best of governance. They have changed their mindset. They have allowed directors of repute to be inducted in the board as independent directors. They are opening up the board for discussion.

The board was closed for discussion. Now, the board has opened up for discussion. Board meetings which were for 10, 15, 20, half an hour. Now, going for 1 hour, one and a half hours, 2 hours. Meetings before the board audit committees, majority independent directors, chairman independent as rounds for few hours much more than what the board meeting time consumes is almost 2 to 2 and a half times the board meeting time.

Quite a few mindsets of the promoters are now even talking of environment, society, governance, which were not the words earlier because it does not add to the bottom line. Now, the bottom line has been replaced by the word called health line. It is not bottom line only. It is not profit only. It is the health of the organisation which the promoters are talking off. Earlier, they used to talk of bottom line and top line.

Top line means revenue; bottom lines meet net profit. In between, they were not concerned. Today, that talking of in between which is the health of an organisation. So, health line is becoming important, not for all, but at quite a few of the promoters. They have felt that going

forward, way forward, the only way is allowed, open, disclose, dialogue. There is a distinct change of mindset and that is a very positive sign for corporate India.

Rules and regulations are all a welcome but mindset change is finally what is required. And that has happened for quite a few promoters. Corporate governance in India, it surely is surely on the upper path. It is very encouraging to see the way forward also looks extremely encouraging, extremely interesting and exciting as well. A lot of facilitators are there in this journey. We have taken by one by one.

Accounting standards are nothing but the guidelines for a statutory auditor to be followed while auditing the accounts of the company. The statutory auditors are basically the persons who go through what is given to them. Now, what is given to them is not what they should go through. They should look for evidence which is not given to them but which are significant and that is their expertise of an auditor, studying the business and knowing the business, understanding the business is very important.

Accounting standards gives various kinds of guidance notes in understanding this. One of the very important aspects of accounting standard which has helped corporate governance, improvisation; corporate governance disciplining, very important is related party transactions. We call it RPT. No one spoke of related party transactions before 10 years. Last 5 Years, they are all discussions. Now, it has become rigid.

For them, it is becoming rigid from next 3 months just down the line January 2002. Every quarter you have to know disclose your related party transactions. Corporate India never thought off; initially, no discussion at all. What is related party transactions? Now, related party transaction means a promoter driven company or a promoter largely promoter hold, held company, all companies are basically owned by a large shareholder.

Now that large shareholder as is holding as well as margin management control to its representatives. Now that large shareholder is not shareholding only this company or having control on this company, he has also a plethora of other companies in which he has got control. Many times, what happens? Business is done between these 2 companies, nothing wrong; nothing wrong.

You can do company business with various companies including the companies in which he is also a majority shareholder in that company also. So, supposing X company majority shareholder, Mr. A, also is a majority shareholder in Y company. Now, X and Y companies entered into transactions. Both the decisions are taken by these 2 companies board of directors in which he has influenced, significant influence being the majority shareholder.

Ideally, when this decision is taken, law is very clear you have to abstain from voting. You will not be counted in that. Legally, that is recorded, but actually what happens that is something to be known. Though he is not voting, but his presence is always there in the mind of the board that this is a company in which majority shareholder has a stake.

So, board might be influenced by that and might take a decision in favour of that. Now, if that happens, then that is a wrong decision. There is a break of corporate governance culture, because you are considering influence; you are not considering merit. Although he is not voting, the majority shareholder is not voting, but the shadow of the majority shareholder is looming large in it. So, what did SEBI do?

SEBI said, accounting standard said, let that be disclosed, nothing else. Let that be disclosed in the annual report initially. Now, it says let that be disclosed every quarter, the quarter related transaction which has happened and disclose it to the stock exchange, so that the whole world comes to know pan India, pan world is good in the institutional investors come to know that this company has entered into a transaction with another company, which are related parties.

Now, supposing I sell my goods to a related party transaction holder company, right fine, fair enough. You can sell. You can sell to anybody you want. But if you have sold, then you disclose that. When you disclose that, you disclose the quantum you have sold and the price you have done. The moment you disclose the price, the world comes to know whether you have done at an arm's length price or not at an arm's length price.

Arm's length mean, whether on an independent basis has the decision taken on merit or not. That is a huge disclosure requirement. And what has happened? This has stopped related party transactions to a large extent. This has stopped another related party transaction. Selling

of goods is not what is the thing to be looked into; what is to be looked into is loans we are giving to related party.

The investments, you are making to that related party. The buying of shares, you are doing of the related party. And why are you buying shares? What amount of money is going to that company? What is the purpose of buying that share? How much dividend you will get from that share? What is the worth of those shares? How do you do the market evaluation of those shares? Are those companies listed?

Are their shares traded? Or is it a private company? Or is a non-listed company? All these questions will open up the basic purpose of investment in related parties. Though the time and inter-corporate deposits used to be given random to associate companies, companies having significant influence at very low rate of interest or even at no rate of interest. Today, all those have stopped.

All related party transactions getting captured each and every, even to the extent of managing director remuneration related party transactions. Company paying salary to the managing director is also getting disclosed verbatim. Any loan to the managing director, even in the ordinary course of business has to be disclosed. Any loan to the KMP even in the ordinary course of business are; not ordinary course of business in.

As per the company policy, he is an employee, he is entitled to get some loan house-building, provident fund, whatever it is, children education that is to be disclosed. How much known has been given to the managing director and what is the interest rate, how much loan has been given to the KMP? So, accounting standards have brought in a lot of disclosure requirements, one of the primary important related party disclosure requirements which has made corporate governance which different level.

And I would also say cleaned up a lot of mess in corporates; cleaned up the balance sheet of corporates is the related party transactions.

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Corporate Governance in India

A Review

- Few New Provisions of Companies Act 2013 for Directors and Shareholders
- One or more women directors are recommended for certain classes of companies
- Every company in India must have a resident director
- The maximum permissible directors cannot exceed 15 in a public limited company. If more directors have to be appointed, it can be done only with approval of the shareholders after passing a Special Resolution
- The Independent Directors are a newly introduced concept under the Act.
- The Independent directors must attend at least one meeting a year

There is another meeting which happens about the independent directors, is that the independent directors they meet have to meet at least once in a year without the other directors, meaning there will be no chairman, there will be no non-executive, non-management directors, only the independent directors, closed door meeting, nobody else is invited, not even the company secretary, not even the CFO, no one, only independent auditors.

What they will do? They will discuss among themselves, whether they are getting enough flow of information from the company they will record that. And all this will be taken by SEBI and other enforcement authorities investing authorities when there is a crisis in that company. Did the independent director record in their meetings that they were not getting any information?

And what steps did you take? Did they take to get that information? Did any of the independent directors in their meeting recorded that? No. If not, they kind of later on blame that we are not privy to information. If yes, recorded and what action you are taking to get that information. So, very little room is there now to play around for the exit route. If you are not doing your due diligence, so independent directors have to be very careful.

They are now responsible, they are having, you are meeting your own independent directors, your body, your team, your team members, nobody else is there. You tell whether you are privy to all the information, number 1. Number 2, you read the performance of the managing

director, evaluate the performance of the managing director. Most importantly, you evaluate the performance of the chairman.

The chairman's performance has to be evaluated by the independent directors in their meeting only. The chairman will not even come to know. They might say, the chairman does not need to listen to us. They might say, the chairman always forces us to listen to him. Or they might say, the chairman does not give him the scope to read. I mean, allow us to speak. If the right, what action they are taking?

In the next meeting, they have to say what action they have taken. Have they brought up before the chairman? Have the disclosures to the chairman? Have the shared this with the chairman? And what are the views of the chairman? And is there any improvement? And if they say no, we are fantastic. Our chairman is brilliant. We are getting all information. Chairman is so good, fine.

Then later on, if something happens, do not tell us the chairman has allowed you to hear your views. So, this is the purpose of the independent directors meeting, no escape route. Very strong due diligence now.

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The slide is titled "Corporate Governance in India" and has a sub-section "A Review". It lists five key points:

- Every company must appoint an individual or firm as an auditor. The responsibility of the Audit committee has increased
- Filing and disclosures with the Registrar of Companies has increased
- Top management recognizes the rights of the shareholders and ensures strong co-operation between the company and the stakeholders
- Every company has to make accurate disclosure of financial situations, performance, material matter, ownership and governance

A small video inset in the bottom right corner shows a man in a blue shirt speaking. The slide also features logos for IIT Madras and NPTEL at the bottom left.

And there is the reason you find; independent directors are no longer much demand. Only if you are sure of an organisation one joints as an independent director, otherwise not.

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Corporate Governance in India

A Review

- Related Party Transactions – A Related Party Transaction (RPT) is the transfer of resources or facilities between a company and another specific party. The company devises policies which must be disclosed on the website and in the annual report. All these transactions must be approved by the shareholders by passing a Special Resolution as the Companies Act of 2013. Promoters of the company cannot vote on a resolution for a related party transaction.
- Changes in Clause 35B – The e-voting facility has to be provided to the shareholder for any resolution is a legal binding for the company.

These are basically to deal with the rights of the shareholders, audit committee, related party transactions. This is most important. Promoters of the company cannot vote related resolution for related party transactions. No, you cannot vote. Moreover, there is a threshold limit. Beyond which, if any transaction goes 10% of the net worth of the company, then shareholder's approval is required.

What approval? Shareholder's approval that too the number of shareholders voting in favour shall be more than the number voting against however the promoter shareholders will not be considered. Now, what will happen then? Supposing, there are 100 is the total number of shares, 60% is held by the promoters and 40% is held by the others. Now, 60% will not vote at all.

In that resolution, only 40% will vote and in that 40% voting, if you take it as 40 shares, then 21 must be in favour and 19 against, then only it will get past, minimum 21. So, promoters influence totally gone; it is only non-promoter shareholders who are going to decide whether this related party transaction will pass or not. Therefore, no promoter will go knowing fully well, it will not pass in on related party transaction exceeding that network, for sure.

So, this is another very, very important move which has been done. Within the network, if it does not contain the network of the company, in that case, fine. You can take a decision related party but you disclose everything to the stock exchange and the public. The moment it crosses that limit of 10%, shareholder approval will be required but the promoters cannot vote.

Other than the disclosure in the in the stock exchange and all, over and above this resolution cannot be passed at all unless it is approved by the shareholders where the promoter will not be able to vote. If the promoter does not vote, the straight away his shareholding goes, supposing he holds 60%, 60% goes, out 100, 60 shares goes, only 40 shares remain and in those 40 shares, 21 must be in favour which is a tall, tall task.

No one will vote for that resolution, which has got related party transactions. People normally shy away from those resolutions and institutional investors if the right not to vote, no one will vote for that. This will go for an absolute loss. I mean it will fail from day 0. Therefore, none of the promoters will take the resolution to the shareholders for passing.

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Corporate Governance in India

A Review

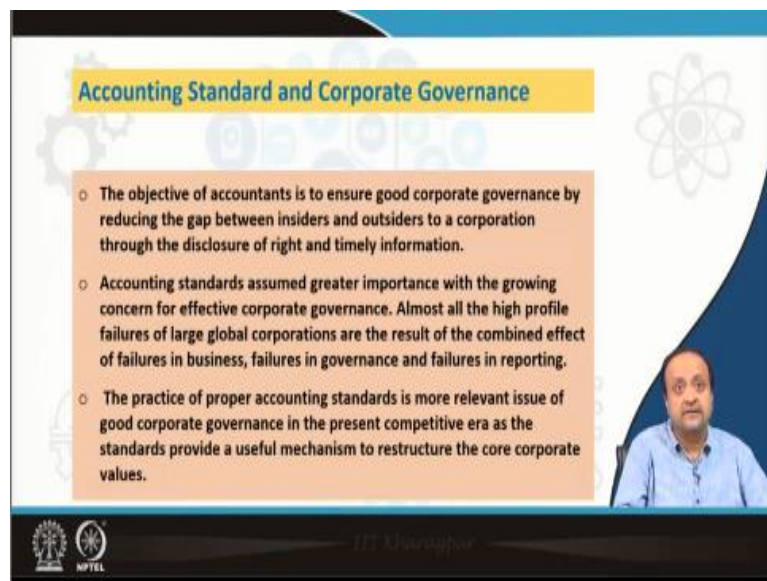
- Corporate Social Responsibility – The company has the responsibility to promote social development in order to return something that is beneficial for the society.
- Whistle Blower Policy – This is a mandatory provision by SEBI which is a vigil mechanism to report the wrong or unethical conduct of any director of the company.

And the prohibition which has been made mandatory by SEBI is a whistleblower provision, very important. Corporate governance to a large extent depends on a proper whistleblower mechanism in an organisation. It should allow employees on a no name basis to blow the whistle. Sometimes wrong whistles are blown. It is true. Some cases, actually are done for a purpose.

However, for that reason, you cannot stop a very good mechanism like we should blow on. It has its pitfalls. It has its pitfalls; it has its challenges, but a mature committee which controls this kind of mechanism which screens, that kind of whistleblower mechanism. I mean, the complaints that come in, can jolly well find out whether it is time to take cognizance of those complaints or not.

Sometimes, these also are placed before the audit committee of the board and sometimes before the risk management committee of the board because both consisting of independent directors. So, there might be a case where it has to be placed before the audit committee take a decision. A certain whistleblower has raised a question of corruption or certain whistleblower has raised a question of certain kinds of risks, it can be raised before the risk management also, but it is a very good mechanism. It has its pitfalls as well.

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The slide is titled "Accounting Standard and Corporate Governance" in a yellow box at the top. Below the title, there are three bullet points in a light orange box:

- The objective of accountants is to ensure good corporate governance by reducing the gap between insiders and outsiders to a corporation through the disclosure of right and timely information.
- Accounting standards assumed greater importance with the growing concern for effective corporate governance. Almost all the high profile failures of large global corporations are the result of the combined effect of failures in business, failures in governance and failures in reporting.
- The practice of proper accounting standards is more relevant issue of good corporate governance in the present competitive era as the standards provide a useful mechanism to restructure the core corporate values.

In the bottom right corner of the slide, there is a small video inset showing a man in a blue shirt speaking. At the bottom left, there are logos for IIT Bombay and NPTEL.

Accounting standards definitely has improved a lot over the years and has become much more demanding from the auditors as well as from the CFO in maintaining the accounts. Large global corporate practices benchmarks have been put in with regard to disclosure requirements, even with regard to valuation of assets, fair value concept has come in. We have been always going into the value of depreciated assets.

Now, fair value concept has come in which is fair in all respects to get the net worth of the company. Many times, deliberately, fair value basis was not taken for income tax gains and purposes. However, now this has been stopped that accounts should be done on a fair value basis.

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The slide features a yellow header with the title 'Corporate governance and Transparency in Accounting'. Below the title, a text box contains the following text: 'Ineffective corporate governance may result in financial crisis both for the company and the stakeholders. Shareholders lose confidence in the company and share prices will decline. The high profile corporate governance failure scams like stock market scam, the UTI scam, Ketan Parekh scam, Satyam scam which were severely criticized by the shareholders called for a need to make corporate governance in India transparent as it greatly affects the development of the country.' A small video inset in the bottom right corner shows a man in a blue shirt speaking. The slide also includes logos for IIT Madras and IITEL at the bottom left.

Ineffective corporate governance will always lead to scams. We have seen a plethora of them. I am not for a moment saying these are only the cases. These are just tip of the iceberg. The iceberg is very deep down and quite a huge one. But it is not that all have to be honest, if they are disciplined, even now that is enough. There is no question of unearthing; unearthing those scams are failures, which are there yet to be disclosed.

But what is important is, no one is trying to score a point on this. Everybody is looking for a better environment for corporate governance. And that is happened; that will happen and that is happening. These measures will make those who have still not come in line, fall in line. Quite a few of the majority shareholders has gone through a mindset change, no doubt about that.

But those who have still not come, just sitting and thinking what should be done, should I think are all going to follow this. It is just a matter of time. There is no escape from this.

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SEBI and Corporate Governance

SEBI Guidelines

- In 1999, the Securities and Exchange Board of India (SEBI) made it mandatory for all listed companies in phases. From April 2003, all the listed companies were brought under mandatory requirement to follow the SEBI corporate governance code.

SEBI guidelines of corporate governance on transparency, integrity, ethical decision making, mitigate the conflicts of interest between shareholders and promoters basically. Shareholder's promoters mean large shareholders or minority shareholders that are the conflict of interest.

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SEBI and Corporate Governance

SEBI Guidelines

- SEBI guidelines for corporate governance are designed to provide a safe, transparent environment for investors and prohibit fraudulent or unfair practices, like insider trading.
- The role of SEBI in ensuring ethical standards among corporations became even more important in 2018 when the organization imposed additional compliance conditions.

A lot of right has been given to the minority shareholders to raise their grievances to write to the regulatory authorities, Ministry of Corporate Affairs, Serious Fraud Investigation Office SFIO. If they find anything like that thought, they can on name basis, fine, send it and investigations are done based on that primer facie evidence there, then only real party disclosures.

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SEBI and Corporate Governance

SEBI Guidelines

- Furthermore, listed companies must disclose related-party transactions and hold a specific number of annual general meetings. SEBI initiatives in corporate governance are largely based on the recommendations made by the Kotak committee in March 2018 and aim to enhance transparency.

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Investment Decisions and Corporate Governance

- Corporate governance exaggerates the impact of investor confidence on corporate investment decisions.
- Good corporate governance practices improve board members' monitoring function, hence moderately control shareholders' interests, therefore firm managers make decisions effectively.
- However, in the presence of rigorous corporate governance practices, the impact of investor confidence on corporate investment is mitigated.

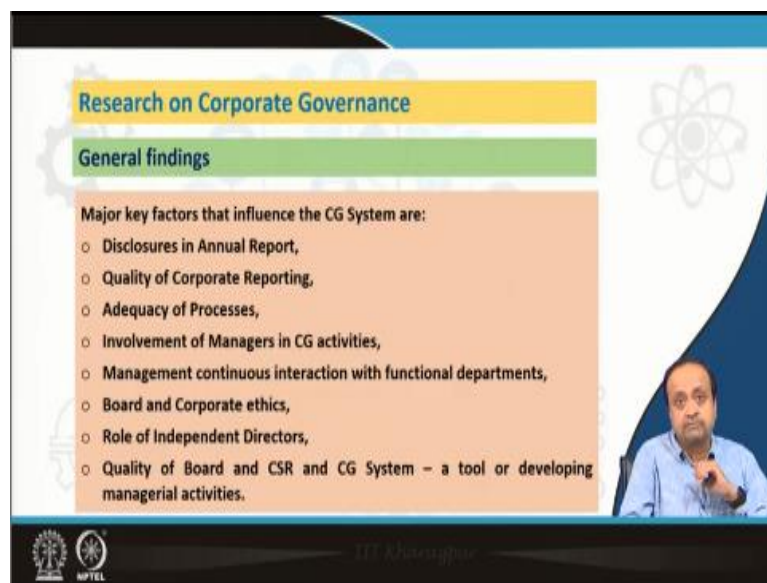
Investment decisions are very important. Investors look into this corporate investment decisions. Today, investors are very foreign portfolio investors do not subscribe to the views of the company as regards investments. Unless and until they are absolutely clear, it is in the same line of business whether it is creating competition or it is further aggravating the situation, whether there is enough players in the market which is already the market is there or you are a new entry.

So, many things they are looking into just because you are making an investment; they are not looking into approving your investment decision. Whether there is a need for going to the market or not, basic question they are asking. Why are coming to the market raise an issue

your internal accruals are enough to fund your expansion, diversification or whatever you are doing. Why are we raising this fund?

Then you must be doing something which is other than that, you are telling you are raising for expansion, diversification, but your results are not showing that you required that. You have enough net worth; you have enough reserves; you have enough past profits. Do your expansion and diversification from there. Why you have come to the market to raise funds? There has to be an answer to that.

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Research on Corporate Governance

General findings

Major key factors that influence the CG System are:

- Disclosures in Annual Report,
- Quality of Corporate Reporting,
- Adequacy of Processes,
- Involvement of Managers in CG activities,
- Management continuous interaction with functional departments,
- Board and Corporate ethics,
- Role of Independent Directors,
- Quality of Board and CSR and CG System – a tool or developing managerial activities.

These are the major filings which are done in the CG system, annual report filing, corporate reporting, management controls interaction, functional departments, any investor presentation you are making, any meet you are having with the financial institutional investors, you have to give that information to the stock exchange first. And before putting that investor presentation to the investors, you have to share it with the stock exchange.

It must go to the stock exchange that this is what I am presenting to the investors. So, that they are not privy to their information, the whole investor community comes to know what you are doing.

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Research on Corporate Governance

General findings

Major key factors that influence the CG System are:

- It also leverages the establishment of strategic alliances that act as a platform for sustainable development.
- Benchmark for good governance should also include benchmarks for monitoring and managing the value creators i.e. intangibles.
- Good governance should also encompass evolving standards to protect, preserve and enhance the value of the value drivers in this sector.

IIT Bombay IIT Madras

Basically, key factors that influence the corporate governance system is not only the fact that independent directors, audit committees, minority shareholders, majority influence of the major shareholders, it is also to do with the sustainable business development programmes that a company does. So, there is a provision now of business responsibility reporting, BRR which is again, our practice to improve corporate governance.

There, a lot of disclosure requirements are there which gives basically, the strength and weaknesses of an organisation as well as the risks and opportunities. So, it is one way a balancing thing. What are the strengths of the organisation? What are the weaknesses? So, the shareholders, investors can come and see and evaluate the company because many times, it is not possible for them to find out what exactly are the risks, what exactly are the strengths, what exactly are weaknesses, what exactly are the opportunities?

So, all this is a separate section for listed companies which are called business responsibility reporting. Various inside information are given on that intrinsic inside information, which is made public and this information is a statutory information, not a non-statutory information duly signed by the all directors. So, the board of directors take responsibility for the statement. This is another good disclosure, which has brought in by SEBI for the investors community to understand the corporate well and accordingly made their decisions.

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CONCLUSION

In this lecture attempt has been made to give an overall ideas about corporate governance (CG) in India, accounting standards, SEBI and CG in India, investment decisions and CG, research on CG. Learners might have been gathering knowledge from the discussion of this introductory lecture



Various references that I have taken, mostly from my experience also, it covers the various aspects of investments, decision making, corporate governance and all. That brings us to the close of this session on lecture. Thank you so much.