Study on the State of Corporate Governance in India

Evolution, Issues and Challenges for the Future

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Executive Summary

Corporate governance in India gained prominence in the wake of liberalization during the 1990s and was introduced, by the industry association Confederation of Indian Industry (CII), as a voluntary measure to be adopted by Indian companies. It soon acquired a mandatory status in early 2000s through the introduction of Clause 49 of the Listing Agreement, as all companies (of a certain size) listed on stock exchanges were required to comply with these norms. In late 2009, the Ministry of Corporate Affairs has released a set of voluntary guidelines for corporate governance, which address a myriad corporate governance issues.

These voluntary guidelines mark a reversal of the earlier approach, signifying the preference to revert to a voluntary approach as opposed to the more mandatory approach prevalent in the form of Clause 49. However in a parallel process, key corporate governance norms are currently being consolidated into an amendment to the Companies Act, 1956 and once the Companies Bill, 2011 is approved the corporate governance reforms in India would have completed two full cycles - moving from the voluntary to the mandatory and then to the voluntary and now back to the mandatory approach.

The Anglo-Saxon model of governance, on which the corporate governance framework introduced in India is primarily based on, has certain limitations in terms of its applicability in the Indian environment. For instance, the central governance issue in the US or UK is essentially that of disciplining management that has ceased to be effectively accountable to the owners who are dispersed shareholders.

However, in contrast to these countries, the main issue of corporate governance in India is that of disciplining the dominant shareholder, who is the principal block-holder, and of protecting the interests of the minority shareholders and other stakeholders.

This issue and the complexity arising from the application of alien corporate governance model in the Indian corporate and business environment is further compounded by the weak enforcement of corporate governance regulations through the Indian legal system.

Furthermore, given that corporate governance is essentially a soft issue, whose essence cannot be captured by quantitative and structural factors alone, one of the challenges of making corporate governance norms mandatory is the need to differentiate between form and content; for instance, how do we determine whether companies actually internalize the desired governance norms or whether they look at governance as a check-the-box exercise to be observed more in letter than in spirit.
Currently, corporate governance reforms in India are at a crossroads; while corporate governance codes have been drafted with a deep understanding of the governance standards around the world, there is still a need to focus on developing more appropriate solutions that would evolve from within and therefore address the India-specific challenges more efficiently.

This paper compiles a history of the evolution of corporate governance reforms in India and through a survey of existing research, identifies issues that are peculiar to the Indian context and which are not being adequately addressed in the existing corporate governance framework.

Lastly, this paper suggests the need for robust research in the field of corporate governance research that would support policy formulation in order to make the next generation of corporate governance reforms more effective for the Indian conditions.
1. Evolution of Corporate Governance in India – A Chronological Perspective

Corporate governance is perhaps one of the most important differentiators of a business that has impact on the profitability, growth and even sustainability of business. It is a multi-level and multi-tiered process that is distilled from an organization’s culture, its policies, values and ethics, especially of the people running the business and the way it deals with various stakeholders.¹

Creating value that is not only profitable to the business but sustainable in the long-term interests of all stakeholders necessarily means that businesses have to run—and be seen to be run—with a high degree of ethical conduct and good governance where compliance is not only in letter but also in spirit.

Historical Perspective

At the time of Independence in 1947, India had functioning stock markets, an active manufacturing sector, a fairly developed banking sector, and also a comparatively well-developed British-derived convention of corporate practices. From 1947 through 1991, the Indian Government pursued markedly socialist policies when the State nationalized most banks and became the principal provider of both debt and equity capital for private firms.

The government agencies that provided capital to private firms were evaluated on the basis of the amount of capital invested rather than on their returns on investment. Competition, especially foreign competition, was suppressed. Private providers of debt and equity capital faced serious obstacles in exercising oversight over managers due to long delays in judicial proceedings and difficulty in enforcing claims in bankruptcy. Public equity offerings could be made only at government-set prices. Public companies in India were only required to comply with limited governance and disclosure standards enumerated in the Companies Act of 1956, the Listing Agreement, and the accounting standards set forth by the Institute of Chartered Accountants of India (ICAI).

Faced with a fiscal crisis in 1991, the Indian Government responded by enacting a series of reforms aimed at general economic liberalization. The Securities and Exchange Board of India (SEBI)—India's securities market regulator—was formed in 1992, and by the mid-1990s, the Indian economy was growing steadily, and Indian firms

had begun to seek equity capital to finance expansion into the market spaces created by liberalization and the growth of outsourcing.

The need for capital, amongst other things, led to corporate governance reform and many major corporate governance initiatives were launched in India since the mid-1990s; most of these initiatives were focused on improving the governance climate in corporate India, which, at that time, was somewhat rudimentary.

**Codifying Good Governance Norms**

The first major initiative was undertaken by the Confederation of Indian Industry (CII), India’s largest industry and business association, which came up with the first voluntary code of corporate governance in 1998. More than a year before the onset of the East Asian crisis, the CII had set up a committee to examine corporate governance issues, and to recommend a voluntary code of best practices.

Drawing heavily from the Anglo-Saxon Model of Corporate Governance, CII drew up a voluntary Corporate Governance Code. The first draft of the code was prepared by April 1997, and the final document titled *Desirable Corporate Governance: A Code*,\(^2\) was publicly released in April 1998. The code was voluntary, contained detailed provisions and focused on listed companies.

Although the CII Code was welcomed with much fanfare and even adopted by a few progressive companies, it was “felt that under Indian conditions a statutory rather than a voluntary code would be far more purposive and meaningful, at least in respect of essential features of corporate governance”.\(^3\) Consequently, the second major corporate governance initiative in the country was undertaken by SEBI. In early 1999, it set up a committee under Kumar Mangalam Birla to promote and raise the standards of good corporate governance.

The Birla Committee specifically placed emphasis on independent directors in discussing board recommendations and made specific recommendations regarding board representation and independence. The Committee also recognized the importance of audit committees and made many specific recommendations regarding the function and constitution of board audit committees. In early 2000, the SEBI board accepted and

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\(^3\) From the preface to the ‘Report of the Committee Appointed by the SEBI on Corporate Governance under the Chairmanship of Shri Kumar Mangalam Birla’ (Birla Committee Report); Available at: <http://www.sebi.gov.in/comrmpreport/corpgovhtml>.
ratified the key recommendations of the Birla Committee, which were incorporated into Clause 49 of the Listing Agreement of the Stock Exchanges.

The Naresh Chandra committee\(^4\) was appointed in August 2002 by the Department of Company Affairs (DCA) under the Ministry of Finance and Company Affairs,\(^5\) to examine various corporate governance issues. The Committee submitted its report in December 2002. It made recommendations in terms of two key aspects of corporate governance: financial and non-financial disclosures, and independent auditing and board oversight of management.

It also made a series of recommendations regarding, among other matters, the grounds for disqualifying auditors from assignments, the type of non-audit services that auditors should be prohibited from performing, and the need for compulsory rotation of audit partners.

The fourth initiative on corporate governance in India is in the form of the recommendations of the Narayana Murthy Committee.\(^6\) This committee was set up by SEBI under the chairmanship of Mr. N.R. Narayana Murthy, in order to review Clause 49, and to suggest measures to improve corporate governance standards. Some of the major recommendations of the committee primarily related to audit committees, audit reports, independent directors, related party transactions, risk management, directorships and director compensation, codes of conduct and financial disclosures.

The Murthy Committee, like the Birla Committee, pointed that international developments constituted a factor that motivated reform and highlighted the need for further reform in view of the recent failures of corporate governance, particularly in the United States, combined with the observations of India’s stock exchanges that

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\(^4\) Following the corporate scandals of the US, the Department of Company Affairs (DCA), Government of India, set up the Naresh Chandra Committee to examine various corporate governance issues; the report of the Committee is available at: [http://www.nfcgindia.org/executive_summary.htm](http://www.nfcgindia.org/executive_summary.htm).

\(^5\) The Department of Company Affairs under the Ministry of Finance was designated as a separate Ministry in 2004 to function under the Minister of State with Independent Charge. The Ministry of Corporate Affairs (MCA) is primarily concerned with the administration of The Companies Act, 1956, other allied Acts, and rules and regulations framed thereunder, mainly for regulating the functioning of the corporate sector in accordance with the law.

\(^6\) Securities and Exchange Board of India, *Report of the SEBI Committee on Corporate Governance (February 2003)*. Available at: [http://www.sebi.gov.in/commrpt/corgov.pdf](http://www.sebi.gov.in/commrpt/corgov.pdf). (Narayana Murthy Committee Report). The need for a review of Clause 49 in India was, in part, triggered by events that occurred in the US such as the collapse of Enron and WorldCom; see, Narayana Murthy Committee Report, at para. 1.6.1: “Recent events worldwide, primarily in the United States, have renewed the emphasis on corporate governance. These events have highlighted the need for ethical governance and management, and for the need to look beyond mere systems and procedures. This will ensure compliance with corporate governance codes, in substance and not merely in form.”
compliance with Clause 49 had up to that point been uneven.

Like the Birla Committee, the Murthy Committee examined a range of corporate governance issues relating to corporate boards and audit committees, as well as disclosure to shareholders and, in its report, focused heavily on the role and structure of corporate boards, while strengthening the definition of director independence in the then-existing Clause 49, particularly to address the role of insiders on Indian boards.

In its present form, Clause 49,\(^7\) called ‘Corporate Governance’, contains eight sections dealing with the Board of Directors, Audit Committee, Remuneration of Directors, Board Procedure, Management, Shareholders, Report on Corporate Governance, and Compliance, respectively. Firms that do not comply with Clause 49 can be de-listed and charged with financial penalties.

In the light of the clear consideration of Anglo-American standards of governance by both the Birla and Murthy Committees, it is not surprising that India’s corporate governance reform effort should contain provisions similar to the reform efforts undertaken outside India that adopted such models. In its final report, the Birla Committee noted its dual reliance on international experiences—both as an impetus for reform following “high-profile financial reporting failures even among firms in the developed economies”,\(^8\) and as a model for reform. Significantly, the Birla Committee singled out the corporate governance reports and codes being applied in the US and UK, such as the Report of the Cadbury Committee, the Combined Code of the London Stock Exchange, and the Blue Ribbon Committee on Corporate Governance in the US. The Committee even directly sought out the input of Sir Adrian Cadbury, chair of the Cadbury Committee, commissioned by the London Stock Exchange, in addition to Indian business leaders.

While the report of the Murthy Committee did not explicitly cite the Anglo-American models of governance, it was clearly a reaction to events in the United States, 

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\(^7\) Clause 49 of the Listing Agreement contains the guidelines on Corporate Governance for all Listed Companies and applies to all Listed Companies (or those that are seeking listing), except for very small companies (that is, those that have a paid-up capital of less than Rs. 30 million and a net worth of less than Rs. 250 million throughout their history). While several requirements of Clause 49 are mandatory in nature, there are certain requirements (such as the setting up of a remuneration committee, training of board members and whistleblower policy) that are merely recommendatory in nature. See Securities and Exchange Board of India circular no. SEBl/CFD/DIL/CG/1/2004/12/10 dated 29 October 2004, Available at: <http://www.sebi.gov.in/circulars/2004/cfdcir0104.pdf>.

\(^8\) Birla Committee Report, Supra. Refer Note 3.
particularly given the timing of the report, which followed just a few months after the
enactment of the Sarbanes-Oxley Act (SOA). There are striking similarities between
Clause 49 and the leading Anglo-American corporate governance standards, in particular
the Cadbury Report, the OECD Principles of Corporate Governance, and Sarbanes-
Oxley.

India's corporate governance reform efforts did not cease after the adoption of Clause
49. In parallel, the review and redrafting of the Companies Act, 1956 was taken up by
the Ministry of Corporate Affairs (MCA) on the basis of a detailed consultative process
and the Government constituted an Expert Committee on Company Law under the
Chairmanship of Dr. J.J. Irani on 2 December 2004 to offer advice on a new Companies
Bill.

Based, among other things, on the recommendations of the Irani Committee,
the Government of India introduced the Companies Bill, 2008, in the Indian
Parliament, which sought to enable the corporate sector in India to operate in a
regulatory environment characterized by best international practices that foster
entrepreneurship and investment. However, due to the dissolution of the Fourteenth
Lok Sabha, the Companies Bill, 2008, lapsed but since the provisions of the
Companies Bill, 2008 were broadly considered to be suitable for addressing
various contemporary issues relating to corporate governance, the Government
decided to re-introduce the Companies Bill, 2008, as the Companies Bill, 2009,
without any change in it except the Bill year.

In January 2009, the Indian corporate community was rocked by a massive accounting
scandal involving Satyam Computer Services (Satyam), one of India’s largest
information technology companies. The Satyam scandal prompted quick action by the
Indian government, including the arrest of several insiders and auditors of Satyam,
investigations by the MCA and SEBI, and substitution of the company’s directors with
government nominees.

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9 The Companies Bill, 2009 was introduced in August 2009 in the Lok Sabha; Available at:<http://www.mca.gov.in/Ministry/actsbills/pdf/Companies_Bill_2009_24Aug2009.pdf>
10 At the end of 2008, India experienced a massive corporate governance scandal involving Satyam Computer Services (Satyam), one of India’s largest technology companies. The Satyam scandal has been described as India’s Enron. *India’s Enron*, ECONOMIST, 8 January 2009, Available at:<http://www.economist.com/business/displaystory.cfm?story_id=12898777>. The company’s founder and chairman, B. Ramalinga Raju, confessed to perpetrating a $1.47 billion fraud on its balance sheet, which he and his brother, Satyam’s Managing Director, had disguised from the company’s board, senior managers and auditors for several years.
For corporate leaders, regulators, and politicians in India, as well as for foreign investors, this necessitated a re-assessment of the country’s progress in corporate governance. As a consequence of various corporate scams, India’s ranking in the CLSA Corporate Governance Watch 2010\(^\text{11}\) slid from third to seventh in Asia.

Shortly after the news of the scandal broke, the CII began examining the corporate governance issues arising out of the Satyam scandal and in late 2009, the CII task force listed recommendations on corporate governance reform.\(^\text{12}\) In his foreword to the Task Force Report, Mr Venu Srinivasan, President of CII, while emphasizing the unique nature of the Satyam scandal, suggested that it was is a one-off incident and that the overwhelming majority of corporate India does business in a sound and legal manner. Nonetheless, the CII Task force put forth important recommendations that attempted to strike a balance between over-regulation and promotion of strong corporate governance norms by recommending a series of voluntary reforms.

In addition to the CII, a number of other corporate groups have joined the corporate governance dialogue. The National Association of Software and Services Companies (NASSCOM) also formed a Corporate Governance and Ethics Committee chaired by N.R. Narayana Murthy, a leading figure in the field of Indian corporate governance reforms. The Committee issued its recommendations in mid-2010, focusing on the stakeholders in the company. The report emphasized recommendations relating to the audit committee and a whistle blower policy, and also addressed the issue of the need to improve shareholder rights. Additionally, the Institute of Company Secretaries of India (ICSI) has also put forth a series of corporate governance recommendations.

Inspired by industry recommendations, the MCA, in late 2009, released a set of voluntary guidelines for corporate governance. These Voluntary Guidelines\(^\text{13}\) address myriad corporate


\(^{12}\) The CII Task Force on Voluntary Governance was headed by Shri Naresh Chandra and submitted its report in November 2009; Available at: http://www.mca.gov.in/Ministry/latestnews/Draft_Report_NareshChandra_CII.pdf.

\(^{13}\) The Ministry of Corporate Affairs issued the Voluntary Corporate Governance Guidelines in December 2009; Available at: http://www.mca.gov.in/Ministry/latestnews/CG_Voluntary_Guidelines_2009_24dec2009.pdf. In his foreword to the Voluntary Guidelines, the Minister of State for Corporate Affairs, Salman Khurshid, explained the rationale of these voluntary guidelines, as follows: “The Ministry of Corporate Affairs has been working towards strengthening of the corporate governance framework through a two pronged strategy. Some aspects which needed to be incorporated in the law have been included in the Companies Bill, 2009, now under examination by Parliament. However, keeping in view the objective of encouraging the use
governance matters, including the independence of the boards of directors; the responsibilities of the board, the audit committee, auditors, and secretarial audits; and mechanisms to encourage and protect whistle blowing. The MCA also indicated that the guidelines constituted a first step in the process of facilitating corporate governance and that the option to perhaps move to something more mandatory remains open.

In parallel, subsequent to the introduction of the Companies Bill, 2009 in the Lok Sabha, the Central Government received several suggestions for amendments in the said Bill from the various stakeholders and the Parliamentary Standing Committee on Finance who also made numerous recommendations in its report. In view of the large number of amendments suggested to the Companies Bill, 2009, arising from the recommendations of the Parliamentary Standing Committee on Finance and suggestions of the stakeholders, the Central Government decided to withdraw the Companies Bill, 2009 and introduce a fresh Bill incorporating the recommendations of Standing Committee and suggestions of the stakeholders.

The revised Bill, namely, the Companies Bill, 2011\(^{14}\) was introduced in the Lok Sabha on 14\(^{th}\) December 2011; however the same was withdrawn by the Government on 22\(^{nd}\) December and sent back for consideration by the Standing Committee on Finance\(^{15}\). The Companies Bill, 2011 is expected to be presented in Parliament in the 2012 budget session.

Though the corporate governance efforts in India have been spearheaded by SEBI over the last decade, the more recent steps have been taken by the MCA. Also there has been an effort to consolidate corporate governance norms into the Companies Act, 1956. Towards that end, the Companies Bill, 2011, does contain several aspects of corporate governance which have hitherto been the mainstay of Clause 49. This represents a trend towards legislating on corporate governance rather than leaving it to the domain of the Listing Agreement. It also signifies a shift in corporate governance

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\(^{15}\) As reported in [http://articles.economictimes.indiatimes.com/2011-12-22/news/30546669_1_companies-bill-development-authority-bill-bjp-leaders](http://articles.economictimes.indiatimes.com/2011-12-22/news/30546669_1_companies-bill-development-authority-bill-bjp-leaders), the opposition BJP leaders argued that since the government had consulted other stakeholders after the Standing Committee had given its report on the Companies Bill, 2009 in August 2010, it should be sent back to the committee again.
administration from SEBI, which oversees the implementation of Clause 49, towards the MCA, which administers the Companies Act.

**Full Circle**

A significant feature of the corporate governance reforms in India has been its voluntary nature and the active role played by public listed companies in improving governance standards in India. CII, a non-government, not-for-profit, industry-led and industry-managed organization dominated by large public listed firms had played an active role in the development of India’s corporate governance norms.

What began as a voluntary effort soon acquired mandatory status through the adoption of Clause 49, as all companies (of a certain size) listed on stock exchanges were required to comply with these norms, a trend which was further reinforced by the introduction of stringent penalties for violation of the prescribed norms. While the Voluntary Corporate Governance guidelines of 2009 represented a move back to a voluntary framework for corporate governance, recent efforts to consolidate corporate governance norms into the Companies Act, 1956 marks a reversal of the earlier approach.\(^{16}\)

In that sense, the corporate governance norms in India appear to have completed two full cycles of oscillating between the voluntary and the mandatory approaches.

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\(^{16}\) See Varrotil, Umakanth, *India’s Corporate Governance Voluntary Guidelines 2009: Rhetoric or Reality?* (2010); Available at: [http://ssrn.com/abstract=163482](http://ssrn.com/abstract=163482), for a detailed evaluation of the substance of the Voluntary Guidelines, and whether a voluntary approach would deliver results in the Indian context. Also see Afsharipour, Afra, *A Brief Overview of Corporate Governance Reforms in India* (December 2010), Available at: [www.conferenceboard.org](http://www.conferenceboard.org), for an overview and assessment of the effectiveness of corporate governance reforms in India.
2. Literature Review
A comprehensive study by Chakrabarti, Megginson, and Yadav has traced the evolution of the Indian corporate governance system and examined how this system has both supported and held back India’s ascent to the top ranks of the world’s economies. The authors of the study have found that while on paper, the framework of the country’s legal system provides some of the best investor protection in the world; enforcement is a major problem in view of the slow functioning of the over-burdened courts and the widespread prevalence of corruption.

Furthermore, ownership of enterprises remains concentrated in a few hands, and family business groups continue to be the dominant business model. However, Chakrabarti, et al have also found that corporate governance in India does not compare unfavorably with that in any of the other major emerging economies of the world, viz. Brazil, China and Russia.

Gupta and Parua attempted to find out the degree of compliance of the Corporate Governance (CG) codes by private sector Indian companies listed in the Bombay Stock Exchange (BSE). Data regarding 1245 companies for the year 2004-2005 was taken for the study from the CG reports (which are included in the Annual Reports) of these companies and 21 codes (of which 19 are mandatory and 2 non-mandatory) were selected for study.

The compliance rate of the CG codes was first tested individually for each company. Further, the mean compliance rate (taking into account all the companies under the study) and the variation among the companies from the mean compliance rate were also tested. It was observed that more than 70 per cent of the sample companies comply with 80 per cent or more of the codes. As regards the code-wise compliance rate, the compliance rate is greater than 80 per cent in respect of 17 codes. Almost all the companies had a compliance rate which is significant even at the 1 per cent level. The authors have stated that nothing more should be concluded from the findings other than that the financial reporting practice of the Indian companies, in general, mostly followed the CG codes contained in Clause 49.

The enforcement of the corporate governance reforms in India has been analyzed by Khanna, who has attempted to find an answer to the paradox of foreign institutional investors (FIIs) increasing their presence and interest in the Indian stock markets when reforms were enacted but not immediately enforced. Khanna has argued that given the high returns available in India, FIIs may have thought that the need for enforcement was not pressing initially (as the chance of insider diversion may not be high at that time), but could become so during the next few years when the market eventually matured.

Khanna's analysis suggests that enforcement is important to the growth of stock markets, but the active civil enforcement of corporate laws may not always be critical to their initial development.

An important empirical study by Dharmapala and Khanna acknowledged the importance of enforcement in corporate governance reform and studied the impact of the introduction of Section 23E to the Securities Contracts (Regulation) Act, 1956 in 2004, which imposed large penalties of Rs. 25 crore for non-compliance with the Listing Agreement (that also includes Clause 49) containing the corporate governance norms. Using a sample of over 4000 firms during the period 1998-2006, this study revealed a “large and statistically significant positive effect (amounting to over 10% of firm value) of the Clause 49 reforms in combination with the 2004 sanctions.” Since Clause 49 did not apply to all listed firms, the researchers could analyze the response of ‘treatment’ groups (firms subject to Clause 49) and compare the same with a ‘control’ groups (firms not subject to Clause 49). The study shows a positive correlation between the introduction of stringent enforcement norms and the market value of the companies.

Jayanth Varma has argued that the corporate governance problems in India are very different from those found in the Anglo-Saxon world and would need a different model for corporate governance, which has a significant external focus. The governance issue in the US or the UK is essentially that of disciplining the management that has ceased.

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20 Ibid.
22 Ibid.
to be effectively accountable to the owners. As against this, the problem in the Indian corporate sector (be it the public sector, the multinationals or the Indian private sector) is that of disciplining the dominant shareholder, who is the principal block-holder, and of protecting the minority shareholders. According to Varma, in the Indian context, it is not possible to resolve the conflict between the dominant shareholder and the minority shareholders.²⁴

Khanna and Palepu have concluded that it did not appear that concentrated ownership in India was entirely associated with the ills that the literature has ascribed to it in emerging markets.²⁵ On the other hand, they felt that if the concentrated owners are not exclusively, or even primarily, engaged in rent-seeking and entry-deterring behaviour, concentrated ownership may not be inimical to competition.

Indeed, they argued, as a response to competition, at least some Indian families have consistently tried to leverage internal markets for capital and talent inherent in business group structures to launch new ventures in environments wherein external factor markets are deficient. An important observation of Khanna and Palepu²⁶ was that concentrated ownership was a result, rather than a cause, of inefficiencies in markets. Even in the low capital intensity, relatively unregulated setting of the Indian software industry, they found that concentrated ownership persisted in a privately successful and socially useful way.

Pratip Kar²⁷ has explored the dynamics of culture and corporate governance in India by calling attention to three areas wherein the clash between the Indian cultural ethos and the Anglo-Saxon norms for good governance are the strongest, viz. related-party transactions; the promoter’s or large shareholder’s actions; and the board’s nominations, deliberations, and effectiveness, and has suggested that Western best practices need to be suitably adapted to be in line with the Indian cultural sensitivities in these areas.

²⁴ Ibid. In Varma’s view, some of the most glaring abuses of corporate governance in India have been defended on the principle of ‘shareholder democracy’, since they have been sanctioned by resolutions of the general body of shareholders, and the Board of the Company has been powerless to prevent such abuses. Therefore, in his view, the remedies against corporate governance abuses can lie only outside the company itself.
²⁶ Ibid.
In a study that used only balance sheet information from four selected sectors of the Indian industry, Mukherjee and Ghosh\textsuperscript{28} analysed the efficacy of corporate governance. Their findings, by and large, painted a disappointing picture with the overall conclusion that corporate governance was still in a very nascent stage in the Indian industry.

The authors found that decision and policy-making was still taken mostly as a routine matter and among the institutional investors also, it seemed that the foreign institutional investors were the most consistent in stock picking whereas the performance of the domestic institutional investors was sporadic and volatile, at best. They also found serious shortcomings in the capital market in not being able to enforce better governance on the part of the directors or performance on the part of the managers.

In the backdrop of the key role played by the dominant shareholder or the promoter, in the Indian context, Varrotil\textsuperscript{29} makes the case that the source for strengthening Indian corporate governance lies within, and the emulation of other systems of corporate governance, or even adopting best practices that may have been successful elsewhere, would only lead to further incongruity with the traditional business systems and practices that are prevalent in India.


\textsuperscript{29} Varrotil, Supra.Note 16.
3. Regulatory Framework for Corporate Governance in India

As a part of the process of economic liberalization in India, and the move toward further development of India’s capital markets, the Central Government established regulatory control over the stock markets through the formation of the SEBI. Originally established as an advisory body in 1988, SEBI was granted the authority to regulate the securities market under the Securities and Exchange Board of India Act of 1992 (SEBI Act).  

Public listed companies in India are governed by a multiple regulatory structure. The Companies Act is administered by the Ministry of Corporate Affairs (MCA) and is currently enforced by the Company Law Board (CLB). That is, the MCA, SEBI, and the stock exchanges share jurisdiction over listed companies, with the MCA being the primary government body charged with administering the Companies Act of 1956, while SEBI has served as the securities market regulator since 1992.

SEBI serves as a market-oriented independent entity to regulate the securities market akin to the role of the Securities and Exchange Commission (SEC) in the United States. The stated purpose of the agency is to protect the interests of investors in securities and to promote the development of, and to regulate, the securities market. The realm of SEBI’s statutory authority has also been the subject of extensive debate and some authors have raised doubts as to whether SEBI can make regulations in respect of matters that fall within the jurisdiction of the Department of Company Affairs.

SEBI’s authority for carrying out its regulatory responsibilities has not always been clear and when Indian financial markets experienced massive share price rigging frauds in the early 1990s, it was found that SEBI did not have sufficient statutory power to

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30 The SEBI Act provides for the establishment of a Board to protect the interests of investors in securities and to promote the development of, and to regulate, the securities market in India, Available at: [http://www.sebi.gov.in/acts/act15ac.pdf](http://www.sebi.gov.in/acts/act15ac.pdf).

carry out a full investigation of the frauds.\textsuperscript{32} Accordingly, the SEBI Act was amended in order to grant it sufficient powers with respect to inspection, investigation, and enforcement, in line with the powers granted to the SEC in the United States.

A contentious aspect of SEBI's power concerns its authority to make rules and regulations. Unlike in the United States, where the SEC can point to the Sarbanes-Oxley Act, which specifically confers upon it the authority to prescribe rules to implement governance legislation, SEBI, on the other hand, cannot point to a similar piece of legislation to support the imposition of the same requirements on Indian companies through Clause 49. Instead, SEBI can look to the basics of its own purpose, as given in the SEBI Act, wherein it is granted the authority to “\textit{specify, by regulations, the matters relating to issue of capital, transfer of securities and other matters incidental thereto . . . and the manner in which such matters shall be disclosed by the companies}.”\textsuperscript{33} In addition, SEBI is granted the broad authority to “\textit{specify the requirements for listing and transfer of securities and other matters incidental thereto}.”\textsuperscript{34}

Recognizing that a problem arising from an overlap of jurisdictions between the SEBI and MCA does exist, the Standing Committee, in its final report, has recommended that while providing for minimum benchmarks, the Companies Bill should allow sectoral regulators like SEBI to exercise their designated jurisdiction through a more detailed regulatory regime, to be decided by them according to circumstances.\textsuperscript{35} Referring to a similar case of jurisdictional overlap between the RBI and the MCA, the Committee has suggested that it needs to be appropriately articulated in the Bill that the Companies Act will prevail only if the Special Act is silent on any aspect.

Further the Committee suggested that if both are silent, requisite provisions can be included in the Special Act itself and that the status quo in this regard may, therefore, be maintained and the same may be suitably clarified in the Bill. This, in the

\textsuperscript{32} The Securities and Exchange Board of India (Amendment) Act, 2002, amended the Securities and Exchanges Board of India Act, 1992 and enlarged its Board of Directors, besides conferring on SEBI the powers of search and seizure, with the approval of courts, and enhancing the fine for a better and hassle-free regulation of the capital market.
The Act is also aimed at avoiding recurrence of scams and other malpractices in the capital market by building confidence among investors.

\textsuperscript{33} SEBI Act, Supra. Refer Note 30.

\textsuperscript{34} SEBI Act, Supra. Refer Note 30.

Committee’s view, would ensure that there is no jurisdictional overlap or conflict in the governing statute or rules framed there under.

**Enforcement of Corporate Governance Norms**

The issue of enforcement of Corporate Governance norms also needs to be seen in the broader context of the substantial delay in the delivery of justice by the Indian legal system on account of the significant number of cases pending in the Indian courts.

A research paper by PRS Legislative Research\(^{36}\) places the number of pending cases in courts in India, as of July 2009, as 53,000 pending with the Supreme Court, 4 million with various High Courts, and 27 million with various lower courts. This signifies an increase of 139 per cent for the Supreme Court, 46 per cent for the High Courts and 32 per cent for the lower courts, from the pending number of cases in each of them in January 2000. Furthermore, in 2003, 25 per cent of the pending cases with High Courts had remained unresolved for more than ten years and in 2006, 70 per cent of all prisoners in Indian jails were under trials. Since fresh cases outnumber those being resolved, there is obviously a shortfall in the delivery of justice, and a consequent increase in the number of pending cases. In addition, the weight of the backlog of older cases creeps upward every year.

This backlog in the Indian judicial system raises pertinent questions as to whether the current regulatory framework in India, as enacted, is adequate to enable shareholders to recover their just dues.

This concern is also articulated in the recent pleadings (filed in January 2010) in the United States District Court, Southern District of New York,\(^{37}\) on the matter relating to the fraud in the erstwhile Satyam Computer Services,\(^{38}\) wherein US-based investors were seeking damages from defendants that included, among others, Satyam and its auditors, PricewaterhouseCoopers (PwC) and has thrown up some very interesting and relevant issues. This case was filed on behalf of investors who had purchased or

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\(^{36}\) PRS Legislative Research (PRS) is an independent research initiative that works with Members of Parliament (MPs) across party lines to provide research support on legislative and policy issues. The summary of their findings on the pendency in Indian Courts is available at: [http://www.prsindia.org/administrator/uploads/general/1310014291~~Vital%20Stats%20-%20Pendencyp%20of%20Cases%20in%20Indian%20Courts%2004Jul11%20v5%20-%20Revised.pdf](http://www.prsindia.org/administrator/uploads/general/1310014291~~Vital%20Stats%20-%20Pendencyp%20of%20Cases%20in%20Indian%20Courts%2004Jul11%20v5%20-%20Revised.pdf)

\(^{37}\) A concise summary of the case and the pleadings before the United States District Court, Southern District of New York (Satyam—case in the USA) can be accessed at: [http://www.legallyindia.com/201102181822/Analysis/exclusive-satyams-settled-us-class-action-had-no-recourse-in-india>.]

\(^{38}\) Satyam, Supra. Refer Note 10.
otherwise acquired Satyam’s American Depository Shares (ADS) listed on the New York Stock Exchange and investors, residing in the United States, who purchased or otherwise acquired Satyam common stock on the National Stock Exchange of India or the Bombay Stock Exchange.

In their pleadings,\(^{39}\) the plaintiffs submitted declarations of two prominent Indian securities law experts: Sandeep Parekh,\(^ {40}\) former Executive Director of SEBI, and Professor Vikramaditya Khanna\(^ {41}\) of the University of Michigan Law School, a leading expert in the United States on the Indian legal system, who filed individual affidavits in which they detailed very cogent and compelling reasons as to why Indian courts cannot redress the harm done to the Class plaintiffs and why India itself does not provide a viable alternative forum for settling the claims of Class members.

In their depositions,\(^ {42}\) among other things, Sandeep Parekh and Vikramaditya Khanna have explained that:

- The substantive laws of India provide no means of individual or class recovery for private investors in securities fraud matters because the civil courts in India are barred from hearing such cases where, as here, SEBI is empowered to act;
- Even if it did provide a substantive means of recovery, Indian law provides no viable class action mechanism under which investors’ claims can be litigated; and
- Indian law does not recognize the fraud-on-the-market presumption of reliance in private civil actions, so that, even if both a substantive means of recovery and a viable class action mechanism existed under Indian law, investors would still be required to demonstrate individual reliance, thus effectively depriving the vast majority of Class members of any prospect of relief.

Khanna stated in his declaration\(^ {43}\) that “The lengthy delays in the Indian Judicial System would leave plaintiff shareholders with effectively no recovery even assuming, arguendo; there might be a potential cause of action.” Sandeep Parekh\(^ {44}\) argued on behalf of the plaintiff shareholders that, not only, as “private parties have no

\(^{39}\) Memorandum of Law (Memorandum) filed by the Lead Plaintiffs in their opposition to the motion filed by the Defendants to dismiss the case before the United States District Court, Southern District of New York can be accessed at: <http://f.lgly.in/download/Satyam-plaintiffs.pdf>.
\(^{40}\) Deposition filed by Sandeep Parekh (Parekh Deposition) as an expert witness on behalf of the Plaintiffs can be accessed at: <http://f.lgly.in/download/Satyam-Parekh.PDF>.
\(^{41}\) Deposition filed by Vikramaditya Khanna (Khanna Deposition) as an expert witness on behalf of the Plaintiffs can be accessed at: <http://f.lgly.in/download/Satyam-Khanna.pdf>.
\(^{42}\) Memorandum, Supra. Refer Note 37.
\(^{43}\) Khanna Deposition, Supra. Refer Note 39.
\(^{44}\) Parekh Deposition, Supra. Refer Note 40.
right to sue to recover damages resulting from the Satyam fraud under Indian statutory or common law because the Indian civil courts have no power to hear disputes where, as in this case, SEBI is empowered to act”, but also that the Satyam investors would “not be able to use the representative action procedure to recover damages because Indian law bars their substantive claims in civil court and the representative action is only a procedural mechanism that cannot create any substantive rights”.

Furthermore, Parekh added that any penalties collected by SEBI related to the Satyam fraud would not go to shareholders of Satyam under the Indian securities law and, unlike the Fair Fund introduced in the United States; penalty amounts collected by SEBI go to the Consolidated Fund of India. He concluded that even if SEBI imposed monetary penalties against the various persons alleged to be a part of the fraud, Satyam shareholders cannot expect any relief from such action.

In 2011, the class action suit was settled by Satyam Computer Services; also Satyam Computer Services Ltd and its former auditor PricewaterhouseCoopers agreed to settle U.S. probes and Price Waterhouse Bangalore, PricewaterhouseCoopers Private Limited, and Lovelock & Lewes (PW India firms) and PwC U.S. and PwC International agreed to settle the New York securities class action suit.

The proceedings in the United States District Court, Southern District of New York, on the Satyam issue have thrown up a number of issues as regards the admissibility and enforceability of the claims of investors many of which remain unresolved and would be tested in the future when similar cases are tried in courts.

45 Ibid.
47 The formal announcement of this settlement, made by the Public Company Accounting Oversight Board (PCAOB) in the US, can be accessed at - http://pcaobus.org/News/Releases/Pages/04052011_DisciplinaryOrders.aspx.
4. Key Issues in Corporate Governance in India – Managing the Dominant Shareholder(s) and the Promoter(s)

The primary difference between corporate governance enforcement problems in India and most western economies (on whose codes the Indian code is largely modelled) is that the entire corporate governance approach hinges on disciplining the management and making them more accountable. The ‘agency gap’ in western economies represents the gap between the interests of management and dispersed shareholders and corporate governance norms are aimed at reducing this gap. However, in India the problem—since the inception of joint-stock companies—is the stranglehold of the dominant or principal shareholder(s) who monopolize the majority of the company’s resources to serve their own needs. That is, the ‘agency gap’ is actually between majority shareholders and other stakeholders.

Secondly, much of global corporate governance norms focus on boards and their committees, independent directors and managing CEO succession. In the Indian business culture, boards are not as empowered as in several western economies and since the board is subordinate to the shareholders, the will of the majority shareholders prevails.

Therefore, most corporate governance abuses in India arise due to conflict between the majority and minority shareholders. This applies across the spectrum of Indian companies with dominant shareholders—PSUs (with government as the dominant shareholder), multinational companies (where the parent company is the dominant shareholder) and private sector family-owned companies and business groups.

In public sector units (PSUs), members of the board and the Chairman are usually appointed by the concerned ministry and very often PSUs are led by bureaucrats rather than professional managers. Several strategic decisions are taken at a ministerial level which may include political considerations of business decisions as well. (The recent case of the PSU oil companies not being allowed to increase the price of oil products in line with the changes in the international crude prices is an example of how the dominant shareholder, the Indian Government, uses its dominance to force decisions that are not always linked to business interests.) Therefore, PSU boards can rarely act in the manner of an empowered board as envisaged in corporate governance codes. This makes several provisions of corporate governance codes merely a compliance exercise.
Multinational companies (MNCs) in India are perceived to have a better record of corporate governance compliance in its prescribed form. However, in the ultimate analysis, it is the writ of the large shareholder (the parent company) which runs the Indian unit that holds sway, even if it is at variance with the wishes of the minority shareholders. Moreover, the compliance and other functions in an MNC is always geared towards laws applicable to the parent company and compliance with local laws is usually left to the managers of the subsidiary who may not be empowered for such a role.

Family businesses and business groups as a category are perhaps the most complex for analysing corporate governance abuses that take place. The position as regards family domination of Indian businesses has not changed; on the contrary, over the years, families have become progressively more entrenched in the Indian business milieu. As per a recent study by the global financial major Credit Suisse,\(^{49}\) India ranks higher than most Asian economies in terms of the number of family businesses and the market capitalization of Indian family businesses as a share of the nominal gross domestic product (GDP) has risen from 9 per cent in 2001 to 46 per cent in 2010.

This survey, which also covered China, South Korea, Taiwan, Singapore, Thailand, Hong Kong, Indonesia, Malaysia and the Philippines, contends that India, with a 67 per cent share of family businesses, ranks first among the ten Asian countries studied. Furthermore, 663 of the 983 listed Indian companies are family businesses and account for half of the total corporate hiring and are concentrated in the consumer discretionary, consumer staples and consumer healthcare sectors.

In addition to the corporate governance issues arising from the dominant family holding in the Indian business companies, there exists an additional complexity on account of the ‘promoter control’ in Indian companies.\(^{50}\) Promoters\(^{51}\) (who may not be holding

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\(^{50}\) Varottill, Supra. Refer Note 16.

\(^{51}\) According to the market regulator SEBI, a Promoter has been defined as a person or persons who are in overall control of the company or persons, who are instrumental in the formulation of a plan or program pursuant to which the securities are offered to the public and those named in the prospectus as Promoters. A director/officer of the issuer or a person acting merely in their professional capacity is not to be included in the definition of the Promoter. Indian law and regulation require that for the sake of protection of the interest of the investing community at the initial stage of going public, Promoters should have a substantial stake in the company. The shareholding interest of the
controlling shares) usually exercise significant influence on matters involving their companies, even though such companies are listed on stock exchanges and hence have public shareholders.

Promoters may be in control over the resources of the company even though they may not be the majority shareholders and, because of their position, have superior information about the affairs of the company than that accessible to non-promoters. As a corollary, in an organization, promoters and non-promoters constitute two distinct groups that may have diverse interests.

The Satyam episode\(^{52}\) illustrated a scenario wherein a company with minimal promoter shareholding could still be subject to considerable influence by its promoters, thereby requiring a resolution of the agency problem between the controlling shareholders and the minority shareholders, even though such problems were not normally expected to arise at the low shareholding levels of the managing group. On 7 January 2009, when the Chairman of Satyam Computer Services, B. Ramalinga Raju, admitted that there had been a systematic inflation of cash on the company’s balance sheet over a period of some seven years, amounting to almost $1.5 billion, the Raju family, who were the promoters of Satyam, held only about 5 per cent of the shares.

A company with 5 per cent promoter shareholding will usually be considered as belonging to the outsider model in terms of diffused shareholding, and hence would require the correction of agency problems between shareholders and managers.\(^{53}\) However, despite the gradual decrease in the percentage holdings of the controlling shareholders, the concept of ‘promoter’ under Indian regulations made the distinction between an insider-type company and an outsider-type company somewhat hazy in this context, and the Raju family, as promoters, continued to wield significant powers in the management of the company despite a drastic drop in their shareholdings over the preceding few years. Furthermore, at Satyam, the diffused nature of the remaining shareholding of the company helped the promoter group to consolidate and exercise

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Promoters must not be less than 20 per cent of the post-issue share capital. Even in a subsequent issue, the Promoters shall either participate to the extent of 20 per cent of the proposed issue or ensure shareholding to the extent of 20 per cent of the post issue capital. Moreover, the minimum Promoter’s contribution must be locked in for a minimum of 3 years. The requirement of minimum Promoter’s contribution shall not be applicable if a company remains listed for three years and above in a stock exchange and has a track record of payment of dividend for at least three immediately preceding years. Subject to these restrictions, the fraction of shares held by the Promoters (and non-Promoters) would be determined by the interplay of various economic factors.

\(^{52}\) Satyam, Supra. Refer Note 10.

\(^{53}\) Varottil, Supra. Refer Note 16.
power that was disproportionate to their voting rights; while the institutional shareholders collectively held a total of 60 per cent shares as of 31 December 2008 in Satyam, the highest individual shareholding of an institutional shareholder was only 3.76 per cent.\textsuperscript{54}

Shah\textsuperscript{56} believes that companies wherein controlling shareholders hold limited stakes could be particularly vulnerable to corporate governance failures and adds that promoters who are in the twilight zone of control, that is, where they hold shares less than those required to comfortably exercise control over the company, have a perverse incentive to keep the corporate performance and stock price of the company at high levels so as to thwart any attempted takeover of the company\textsuperscript{56}.

The Satyam case clearly demonstrates the inability of the existing corporate governance norms in India to deal with corporate governance failures in family-controlled companies, even where the level of promoter shareholding is relatively low.

Future governance reforms thus need to address the matter of promoters with minority shareholding, who are in effective control of managements in such companies that lie at the cusp of insider and outsider systems.

\textbf{Increasing Public Float of Shares}

Corporate governance theory suggests that widely held companies are better governed than closely held companies and that countries must work toward increasing the size of and deepening the capital markets. A beginning in this direction was made by the Ministry of Finance in June 2010, when it amended the Securities Contract (Regulation)
Act to set a limit of 25 per cent as the minimum public shareholding for initial as well as continued listings on Indian stock markets.\textsuperscript{57}

This amendment seeks to increase the public float of shares so that companies in India necessarily have to have a degree of widely dispersed holding. Existing listed companies having less than 25 per cent public holding have to reach the minimum 25 per cent level by an annual addition of not less than 5 per cent to the public holding. Also, if the public shareholding in a listed company falls below 25 per cent at any time, such a company has to bring the public shareholding to 25 per cent within a maximum period of 12 months from the date of such a fall.

This is a good milestone for broadening the shareholder base in the country; however, the actual implementation of this requirement may be challenging, especially for public sector companies, not in the least because the capital market may not be ready to absorb what will certainly be large issue sizes to comply with the threshold limit. Hence in August 2010, there was another amendment to the Securities Contract (Regulation) Act, which exempted public sector companies from this threshold of 25 per cent public shareholding. The exemptions are at two levels: a) for companies that have a public shareholding of 10 per cent or more, may raise it to 25 per cent over a period of three years, and b) for other PSUs, the threshold limit is kept at 10 per cent to be reached in three years.\textsuperscript{58}

Corporate governance processes presently in convention are designed with a view to serve the shareholders and protect them from managerial excesses. However, this premise is turned on its head when companies are run by a dominant shareholder or group. A corporate governance regime which involves strengthening board processes alone would be rather irrelevant to solve the problems of governance abuses by dominant shareholders.

\textsuperscript{57}www.finmin.nic.in/the_ministry/dept_eco_affairs/capital_market_div/Amendment_Securt_contract_1957.pdf

\textsuperscript{58}http://finmin.nic.in/the_ministry/dept_eco_affairs/capital_market_div/Securt_contract_Rule_2ndAmnd.pdf, The Gazette of India, Extraordinary, Part-II, Section 3, Sub-section (I), Ministry of Finance, (Department of Economic Affairs), New Delhi, 04 June 2010.

5. Companies Bill, 2011 and its Impact on Corporate Governance in India

The foundations of the comprehensive revision in the Companies Act, 1956 was laid in 2004 when the Government constituted the Irani Committee\(^{59}\) to conduct a comprehensive review of the Act. The Government of India has placed before the Parliament a new Companies Bill, 2011\(^{60}\) that incorporates several significant provisions for improving corporate governance in Indian companies which, having gone through an extensive consultation process, is expected to be approved in the 2012 Budget session.

The new Companies Bill, 2011 proposes structural and fundamental changes in the way companies would be governed in India and incorporates various lessons that have been learnt from the corporate scams of the recent years that highlighted the role and importance of good governance in organizations.

Significant corporate governance reforms, primarily aimed at improving the board oversight process, have been proposed in the new Companies Bill; for instance it has proposed, for the first time in Company Law, the concept of an **Independent Director** and all listed companies are required to appoint independent directors with at least one-third of the Board of such companies comprising of independent directors.

The Companies Bill, 2011 takes the concept of **board independence** to another level altogether as it devotes two sections\(^{61}\) to deal with Independent Directors. The definition of an Independent Director has been considerably tightened and the definition now defines positive attributes of independence and also requires every Independent Director to declare that he or she meets the criteria of independence.

In order to ensure that Independent Directors maintain their independence and do not become too familiar with the management and promoters, **minimum tenure** requirements have been prescribed\(^{62}\). The initial term for an independent director is for five years, following which further appointment of the director would require a special resolution of the shareholders. However, the total tenure for an independent director is not allowed to exceed two consecutive terms.


\(^{60}\) The Companies Bill,2011; Supra. Note 14

\(^{61}\) Section 149 and 150 of The Companies Bill, 2011, Supra. Note 14.

\(^{62}\) The Companies Bill, 2011; Supra. Note 14.
The new Companies Bill, 2011 expressly disallows Independent Directors from obtaining **stock options** in companies to protect their independence.

The new guidelines which set out the role, functions and duties of Independent Directors and their appointment, resignation and evaluation introduce greater clarity in their role; however, in certain places they are prescriptive in nature and could end up making the role of Independent Directors quite onerous.

In order to balance the extensive nature of functions and obligations imposed on Independent Directors, the new Companies Bill, 2011 seeks to **limit their liability** to matters directly relatable to them and limits their liability to “only in respect of 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”\(^{63}\). In the background of the current provisions in the Companies Act, 1956 which do not provide any clear limitation of liability and have left it to be interpreted by Courts\(^ {64}\), it is helpful to provide a limitation of liability clause.

The new Bill also requires that all resolutions in a **meeting convened with a shorter notice** should be ratified by at least one independent director which gives them an element of veto power. Various other clauses such as those on directors’ responsibility statements, statement of social responsibilities, and the directors’ responsibilities over financial controls, fraud, etc, will create a more transparent system through better disclosures.

A major proposal in the new Bill is that any undue gain made by a director by abusing his position will be **disgorged** and returned to the company together with monetary fines.

\(^{63}\) Id.

\(^{64}\) The 2009 experience of Nimesh Kampani, one of India’s leading investment bankers is very relevant to see how unstable the position of independent directors is under the Companies Act, 1956. Kampani served as an independent director on the board of Nagarjuna Finance from 1998 to 1999.21 The promoters and executives of Nagarjuna were later charged under the Andhra Pradesh Protection of Creditors Act for failing to repay depositors nearly Rs. 100 crore during 2001-2002. Surprisingly, in addition to charging and arresting the founding promoter and another affiliated director, the Government also charged Kampani, who had left the board prior to any of the allegations surfacing. Kampani managed to avoid arrest and jail time by remaining in Dubai for nine months until a ruling by the Supreme Court of India in October 2009 stayed the proceedings against him. [http://www.hindustantimes.com/News-Feed/India/Supreme-Court-stays-arrest-of-Nimesh-Kampani/Article1-395918.aspx](http://www.hindustantimes.com/News-Feed/India/Supreme-Court-stays-arrest-of-Nimesh-Kampani/Article1-395918.aspx)
Other significant proposals that would lead to better corporate governance include closer regulation and monitoring of related-party transactions, consolidation of the accounts of all companies within the group, self-declaration of interests by directors along with disclosures of loans, investments and guarantees given for the businesses of subsidiary and associate companies.

A significant first, in the proposals under the new Companies Bill, is the provision that has been made for class action suits; it is provided that specified number of members may file an application before the Tribunal on behalf of members, if they feel that the management or control of the affairs of the company are being conducted in a manner prejudicial to the interests of the company or its members. The order passed by the Tribunal would be binding on the company and all its members. The enhanced investor protection framework, proposed in the Bill, also empowers small shareholders who can restrain management from actions that they believe are detrimental to their interests or provide an option of exiting the company when they do not concur with proposals of the majority shareholders.

The Companies Bill, 2011\textsuperscript{65} seeks to provide clarity on the respective roles of SEBI and the MCA and demarcate their roles – while the issue and transfer of securities and non-payment of dividend by listed companies or those companies which intend to get their securities listed shall be administered by the SEBI all other cases are proposed to be administered by the Central Government. Furthermore, by focusing on issues such as Enhanced Accountability on the part of Companies, Additional Disclosure Norms, Audit Accountability, Protection for Minority Shareholders, Investor Protection, Serious Fraud Investigation Office (SFIO) in the new Companies Bill, 2011, the MCA is expected to be at the forefront of Corporate Governance reforms in India.

\textsuperscript{65}The Companies Bill, 2011; Supra., Note 14.
6. Policy Formulation - Need for Robust Research to Guide Future Policy Initiatives

High profile corporate scandals like Enron, Satyam, etc have brought into public consciousness the mundane subject of corporate governance reforms in the hope that implementing good governance in organizations would not only prevent the recurrence of such problems but also lead to good organizational performance.

The last decade has also seen a flurry of regulations introduced across different countries in the world aimed at improving corporate governance practices in organizations; however, the results from such regulatory changes have been mixed. Indeed some have even argued that introducing corporate governance regulations is no guarantee that we have seen the last corporate governance break down.

Effectiveness of corporate governance regulations depends on having satisfactory answers to the following two questions:

- Are the regulatory changes in corporate governance based on sound theory or are they based on popular perceptions and a common position that is arrived at based on the negotiation of the divergent views of various interest groups who are affected by the regulatory changes?

- How robust is the underlying theory of corporate governance, in particular the linkage of good governance to good performance – does it comprehensively model all the factors that impact corporate governance and accounts for differences in contextual and cultural factors that could impact governance. Also, has the corporate governance theory been tested empirically based on actual conditions and have the conclusions been tested for their validity?

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66 Reporting on subject of corporate governance in the media has increased significantly after the various corporate scams surfaced in the beginning of the twenty-first century. As pointed out by Bhagat et al; The Promise and Peril of Corporate Governance (Supra. Note 82) in the nearly five years since Enron’s collapse, there have been 1,342 New York Times news stories containing the phrase “corporate governance,” whereas to reach a comparable count prior to that date, one has to cumulate news stories over ten years to 1986 (totaling 1,388), as searched in Lexis in September 2006.

67 Mark J. Roe; The Inevitable Instability of American Corporate Governance (2004) downloaded from [http://papers.ssrn.com/sol3/papers.cfm?abstract_id=615561](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=615561), points to the inherent brittleness in corporate governance regulation since it is based on negotiations between the regulator who believe that they must lock everything in and the regulated who is able to affect the regulator and weaken the output. Roe suggests that we will continue to face corporate governance crises from time to time as new stress points develop and only if we’re lucky, someone will anticipate the problem and fix it up beforehand, if not, we’ll muddle through another crisis once again.
Unfortunately, the world over, the current answer to both the above questions are not very satisfactory and India is no exception. Quite often regulatory changes have been made without being rooted in sound theory. The current status of corporate governance research, especially an understanding of the factors that links corporate governance to good performance, has several gaps and conclusions derived from such findings, at times, do not hold up to rigorous testing.

Over the last decade, while significant steps have been taken by the regulatory authorities in India to enhance corporate governance measures in India; these developments have closely followed efforts in other jurisdictions such as the U.K. (the Cadbury Committee Report) and the U.S. (SOX). The mechanism of market forces in western economies presumes the existence of a deep and liquid market in shares, which is not a reality in India. Besides, stock markets have proven to be only partially successful in ensuring good corporate governance even in developed and mature economies.

**The major challenges to corporate governance reforms in India are:**

- Power of the dominant shareholder(s)
- Lack of incentives for companies to implement corporate governance reform measures (no direct correlation between putting expensive governance systems and corresponding returns)
- Underdeveloped external monitoring systems
- Shortage of real independent directors
- Weak regulatory oversight including multiplicity of regulators

India needs and deserves a well-designed policy framework that takes into account all these concerns while being aligned to global developments. That is, home-grown solutions to our unique problems. While the need to have public policy (relating to corporate governance) firmly grounded in sound theory is indisputable, there is the need to improve the robustness of research on corporate governance itself and develop a more robust theory for corporate governance—an area where several concerns exist at present. Despite a growing body of empirical literature on corporate governance reforms in India and their impact on Indian companies there is a need for further and more detailed research to fully understand the underlying issues that affect corporate governance in India. Only a proper understanding of the underlying issues would help in
evolving a framework for reforms appropriate to the Indian situation and ethos, which would have much greater chance of success as compared to any ad hoc reform measures.

It would augur well for Indian companies if the corporate governance debate in the country were to transcend beyond conventional anecdotal wisdom and is based on research to facilitate the development of models that take into account distinctive Indian factors which are characteristic of the business environment in India.

In association with the Indian Institute of Corporate Affairs and Indian Institute of Management, Kolkata Thought Arbitrage Research Institute (TARI) proposes to bring out a series of discussion papers, based on empirical research that has been conducted, which would focus on various facets of Corporate Governance in Indian companies. Placing these papers in the public domain would help to initiate a debate on these very important issues and provide an input for more robust policy formulation.

Indeed, corporate governance reforms in India now stand at an interesting crossroads, and the future development of the next generation reforms and in their implementation during the current decade, will decide how effective they are for Indian business.