Critical Essay on- Redefining Accountability of Directors: Towards Corporate Governance and Fairness

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ABSTRACT
The term 'corporate governance' is the new talk of the town, and this is because no investor would be comfortable investing in a company that is not backed by sound policies, stable system and overall confidence shaping environment. If investors have faith in the company and is inspired by its activities, the level of investor's trust is a recipe for success for a company to keep them going. Sound corporate governance is what propels our economy into a market based one. The importance of corporate governance has taken flight in our country, more so because of our exposure and intermingling with international agencies. Through this essay, the researcher has analysed, appreciated, and recognized four initiatives introduced to deepen the roots of corporate governance in our country- Confederation of Industry Code, Kumar Mangalam Committee Report, Naresh Chandra Committee Report and Narayan Murthy Committee Report. Subsequently, the researcher has laid emphasis on critically analysing the status of corporate governance in India and the current challenges that we face in the thirst of its effective implementation. Lastly, the researcher has also recognized the value that shareholder activism can play in transforming corporate governance. In furtherance of this, the SEBI has introduced the Investor Education Protection Fund to arm shareholders with information and knowledge befitting them to take a stand.

Keywords: *Corporate Governance, CII Code, Kumar Mangalam Committee Report, Naresh Chandra Committee Report, Narayan Murthy Committee Report, Shareholder activism*

INTRODUCTION TO THE NEED FOR CORPORATE GOVERNANCE

The corporate law framework in India has been darkened ever since famous occurrences such as Satyam and Nirav Modi scams took place. To strengthen the corporate structure, the Government had introduced the Companies Act, 2013, to ensure that such scams do not take place in India.[1]The Parliamentary Standing Committee on the Companies Act, 2009 had discovered that the reason the Satyam scam occurred was because directors were given too much independence. [2]To correct this fallacy, the functions, duties, and liabilities of independent directors were greatly emphasized upon in the Companies Act, 2013 and the Securities and Exchange Board of India (SEBI) (Listing Obligations and Disclosure Requirements) Regulations, 2015. [3]Before 2013, importance of defining the boundaries within which independent directors could operate were not delved into by the Companies Act, 1956 nor the SEBI Listing Agreement.[4]

MEANING OF CORPORATE GOVERNANCE

Sir Adrian Cadbury defined the concept of corporate governance as, "*the system by which companies are directed and controlled".*[5]
The interests of the following stakeholders must be balanced:

i. Shareholders
ii. Customers
iii. Management
iv. Company

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[1] Richa Bhattacharyya and Sachin Dave, *Lesson from Satyam Scam: Corporate Governance Evolves, not Execution*, ET, Jan. 7, 2016.
[2] Kaushik Dutta, HANDBOOK FOR INDEPENDENT DIRECTORS: UPHOLDING THE MORAL COMPASS (2nd ed., 2017).
[3] Avtar Singh, INTRODUCTION TO COMPANY LAW (11th ed., 2014).
[4] Shinoj Koshy et al., *The Responsibilities, Rewards and Liabilities of Independent Directors will be transformed by the New Companies Act*, IBLJ, 25-26, 2014.
[5] Cadbury Committee Report, *A report by the Committee on the financial aspects of corporate governance,* May 27, 1992.

v. Community
vi. Government
vii. Suppliers

Former World Bank President Wolfensohn defines corporate governance as the "*promotion of corporate fairness, transparency and accountability.*"[6]

Good corporate governance is a combination of ***performance*** and ***conformance.*** The essence of corporate governance can be categorized into four parameters:
i. Creation of a successful economic market-based environment
ii. Efficient distribution of capital and enhancement of financial markets as a whole
iii. Increasing growth and scope for Foreign Direct Investment (FDI)
iv. Contributing to the development of a nation on a large scale

To achieve these objectives, Corporate Governance can be divided into two models:
(a) 'Outsider Model'/ Anglo-American model: Prime focus is on shareholders.
(b) 'Coordinated Model'/ German and Japanese model: Prime focus are multi-stakeholders.

If any conflict with respect to resolving these disputes arises, it is solved in the form of adopting processes, customs, framing policies and regulations, which have a bearing in the way a company is controlled.[7]

CORPORATE GOVERNANCE IN INDIA

Corporate Governance became a focus of India ever since 1991, when India adopted Liberalization, Privatization and Globalization in our economy. When the Government approached the IMF due the financial crisis that it faced in 1991, the Indian Government was advised to adopt ***reformative actions*** to achieve ***economic stabilization.***

A. Confederation Of Indian Industry (CII) Code:

The CII critically analysed and monitored issues of corporate governance and based on the expertise of the committee, a recommendation of a *voluntary code* of best practices were adopted- by banks, financial institutions, private and public companies. In 1997, the CII released its code titled, "Desirable Corporate Governance: A Code" which was followed by the final draft in the subsequent year. In promotion of corporate governance, the following disclosures needed to be met with:
i. Companies listed on major stock exchanges must reveal data concerned with highs and lows of monthly average share prices, % share in sales revenue and future prospects.[8]
ii. For companies listed on major stock exchanges, there must be a requisite for companies to provide for a ***corporate governance compliance certificate*** which must be duly signed by the CEO and CFO.
iii. If a company desires to approach multiple ***credit rating agencies,*** then it must disclose the ratings that it has received from all agencies, in the prospectus and issue document. These details must be expressed in a tabular form of representation from higher to lower ranking.
iv. If companies have ***defaulted on fixed deposits,*** they must neither be permitted to accept fresh deposits, nor make inter corporate loans or declare dividend, unless such a default on fixed deposits is reversed.

B. Kumar Mangalam Birla Committee Report & Clause 49 in the SEBI Listing Agreement:

Although the Code under CII was greatly appreciated and renowned, it was believed that a statutory backing was in dire need, as the Code under CII was merely voluntary. Thus, the SEBI incorporated the recommendations put forth by Kumar Mangalam Birla Committee's and presented it in the form of *Clause 49 of the Listing Agreement.* The recommendations by this committee can be classified into: Mandatory and Non-mandatory.

Mandatory Recommendations in furtherance of Corporate Governance include:
i. "*Accountability*": The BODs must be accountable to the shareholders
ii. "*Composition of the Board"*: The BODs must be independent in nature and must comply with the following:

For listed companies, If the Chairperson of the Board of Directors (BOD) is a non-executive director, then:

At least 1/3rd of BODs shall be Independent Directors

[6] World Bank President, J. Wolfensohn, *International Corporate Governance,* Financial Times, June 21, 1999.
[7] Supra note 3.
[8] Supra note 4.

For listed companies, that do not have a non-executive Chairperson, then:[9]

At least 1/2 of BODs shall be Independent Directors

Any transactions which are pecuniary in nature and take place by non-executive directors must be disclosed in the annual report.

iii. *"Nominee Directors"*: These directors should be appointed on a selective basis in cases where such an appointment is considered crucial to safeguard the rights and interests of the institutions.

Non- mandatory Recommendations in furtherance of Corporate Governance include:

Progressive measures of corporate governance must be adopted by all the BODs as well as the audit committee. It is recommended that the BOD must establish an audit committee that is qualified and independent in nature.

A. Naresh Chandra Committee Report:

The underlying focus of this committee was to focus on corporate governance issues concerning *auditor-client relationships*. Crucial recommendations were made and can be categorized into: Financial and Non-financial disclosures. Suggestions were mainly centered to improve the roles, remuneration and training of independent directors.

B. Narayana Murthy Committee Report on Corporate Governance:

The SEBI analysed the effectiveness and implementation of Clause 49 of the SEBI Listing Agreement and came to the conclusion that was a need to go beyond the book of strictly abiding to procedures and systems. Thus, this was the last initiative on corporate governance which was introduced under the chairmanship of Mr. Murthy to review and re-evaluate Clause 49. The recommendations made by the committee pertained to related party transactions, code of conduct, compensation for directors and risk management.

CRITICAL ANALYSIS OF THE EFFECTIVENESS OF CORPORATE GOVERNANCE IN INDIA

The underlying impediment with respect to the effective implementation of corporate governance is that such director-related positions are easily influenced by individuals. [10]Directors have the power to transfer assets between companies and can easily allot shares on a preferential basis. Although there are provisions in the Companies Act which addresses and protects interests of minorities, there is no separate and effective statutory legislation. Shareholders owning maximum shares in a company appoint independent directors- who are either known individuals, allies, or members of a family.[11] In some organisations, the CEO of an organization is the Chairman of the BOD which signifies that the supervisory role of the BOD is at serious stake. With this influence, there are high chances that the management will undertake activities to promote their interest. Thus, it is very essential to have a control over the shareholders in a company, during the selection of the BODs. [12]

An increase in corruption that takes place in government organisations is what kept blinds society on the kind of corruption that takes place in business and industrial organisations, and thus, it is only after a long duration that directors are held accountable for their misdeeds. The possibility of getting caught after an extended period of time is what motivates directors and promoters to engage in unethical practices. Even though Section 299 of the Companies Act, 1956 has made efforts for directors to reveal their "connections and economic interest with the company", it is rather ineffective.[13] Another aspect which contributes to ineffectiveness, is that many a times meetings are organized for shareholders, however, many a times there is no logical flow of communication and ideas which is a failure in the effective implementation of corporate governance.

[9] SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 Regn. 17 (1) (b).

[10] Supra note 1.

[11] Rujitha T.R., *Challenges to Corporate Governance: Issues and Concerns*, IJMFSMR, 12 Vol. 1, December 2012.

[12] Balasubramanian, *Strengthening Corporate Governance in India: A Review of Legislative and Regulatory Initiatives*, IIM B, 2019.

[13] Maria Maher et al., *Corporate Governance: Effects on Firm Performance and Economic Growth,* OECD, 1999.

To better corporate governance and make directors more accountable for their actions, the Directors have to mandatorily mention a responsibility statement in the company's annual reports. The statement must reflect the following:

i. The relevant accounting standards that have been adhered to during the preparation of the annual accounts.
ii. Kinds of accounting policies adopted and reasonable estimates that determine the true state of affairs in a company.
iii. The level of precaution that a company has undertaken to ensure that fraud can be prevented and detected in their accounting records.
iv. Re-iterate that the accounts of a going concern is being prepared on an annual basis
v. Assure shareholders and the public that there are mechanisms relating to internal financial controls that are in existence.
vi. Ensure the effective application of laws, compliances and proper mechanisms in check.

CONCLUSION

Thus, it can be inferred that the biggest challenge India faces with respect to effective implementation of corporate governance is simply the kind of influence that can be exercised by dominant shareholders. Even though the return of effective governance cannot be quantifiable, there is still visible returns in the form of smooth implementation of compliances and less instances of fraud and corruption. India certainly has a multitude of regulators, however the roadblock that the country faces is in its weak monitoring system. What India currently lacks in are skilled managerial personnel and independent directors.

Good corporate governance is a *sine qua non* whose primary aim is: ***provide success in the long term to all shareholders and stakeholders.*** [14] The Companies Bill in 2009 aimed at introducing class action suits against any misconduct done by a member of the company or a group of such individuals if there has been any false or misleading statement in the prospectus.[15] One prevalent problem that exist among shareholders is that they are ***financially illiterate.*** In furtherance of this, the Ministry of Corporate Affairs (MCA) has established the IEPF (Investor Education Protection Fund) to educate investors. Only when shareholders are armed with knowledge, armed about the rights, can there be growth for shareholder activism. If there is structured and enhanced shareholder activism, that can play a tremendous role in shaping corporate governance to the way that it is intended to be.

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[14] Pankaj Kumar et al., *Evolving Legal framework of Corporate Governance in India- Issues and Challenges*, 2 JURIDICAL TRIBUNE, Vol. 4, Dec. 2014.

[15] Vijay Singh, *Recent Developments in Corporate Governance in India: Role of Shareholder's Activism,* 3 JOURNAL ON GOVERNANCE, Vol. 1, pp. 297-306, 2010.