REPORT

ON

CORPORATE EXCELLENCE ON A SUSTAINED BASIS TO SHARPEN INDIA’S GLOBAL COMPETITIVE EDGE AND TO FURTHER DEVELOP CORPORATE CULTURE IN THE COUNTRY

Department of Company Affairs,
Ministry of Law, Justice & Company Affairs
Government of India
New Delhi – 110 001.
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Department Of Company Affairs has been making necessary changes in the Companies Act, 1956 and the rules made thereunder to keep pace with the globalization process. The provisions relating to 'nomination facility for shareholders and deposit-holders'; 'buy-back of securities'; 'relaxation in norms relating to inter-corporate loans and investments'; 'setting up of Investor Education and Protection Fund'; 'allowing sweat equity' and 'Compliance of accounting standards in preparation of annual accounts' were certain important provisions introduced through Companies (Amendment) Act, 1999 (w.e.f. 31.10.1998) to provide initiatives and safeguards for improved investor protection and better corporate governance. The Companies Act, 1956 has again been amended vide Companies (Amendment) Act, 2000 providing for Postal Ballot, Audit Committee, Directors Responsibility Statement, Debenture Trustees, Secretarial Compliance Certificate, Reduction of Time for Payment Dividend (including interim dividend), ten fold increase of fines and Option for Election of a Director by Small Shareholders etc.

The Company Law Settlement Scheme, 2000 and Fast Track Scheme, 2000 launched by this Department are other steps towards improved corporate governance. Through these Schemes, a successful attempt was made to create an environment of trust, confidence and partnership wherein companies which defaulted in filing documents with the Registrar of Companies in the past came forward and availed one time declaration and settlement. The Companies availing of the 'Fast Track Scheme, 2000' will be enormously benefited as it provides a simple 'exit route' for non functional companies saving them from protracted process of winding up.

Certain steps have also been initiated by SEBI for good corporate governance and investor protection.
In order to operationalize the concept of corporate governance / excellence on a sustained basis to sharpen India's global competitive edge and to further promote and develop corporate culture in the country, the Department of Company Affairs had set up on 15.5.2000 a Study Group. The Group comprised eminent professionals of the country namely:

1. Shri Kumar Mangalam Birla  
Chairman, Aditya Birla Group
2. Shri M R Rao  
Director, Indian Institute of Management Bangalore
3. Shri N H Mirza  
C/o S R Batliboi and Company
4. Shri P M Narielvala  
Former Sr. Partner, S R Batliboi & Company  
And Past President, The ICAI  
Calcutta
5. Dr M B Athreya  
Management Adviser, New Delhi
6. Shri Maninarayan Swami  
Adviser, UB Group of Companies
7. Shri Mukesh Ambani  
Vice-Chairman and MD  
Reliance Industries Limited
8. Shri Rajiv Chandrasekhar  
CMD, BPL Telecom Centre
9. Shri S Rajagopalan  
Former Chairman, MTNL, New Delhi
10. President,  
The Institute of Chartered Accountants of India  
New Delhi
The Study Group had in its first meeting held on 9.5.2000 in New Delhi constituted a Task Force. This Task Force was headed by Shri S. Rajagopalan and with Shri J Sridhar, Shri M.R. Rao and Shri P.M. Narieivala as members. Prof. N. Balasubramanian, Indian Institute of Management, Bangalore was also co-opted. The Task Force met on several occasions at Delhi and Bangalore. The members of the Study Group had also met with the delegates of "Common Wealth Secretariat on Centre in Corporate Governance, U.K". comprising of Mr.Michael Gillibrand from U.K, Mr. Pat Mahoni, Company Secretary from South Africa, Ms. Jenny Warcoe and Mr. Darcy Smith both from Australia and Prof. Y.R.K. Reddy. The Task Force also interacted with various Chambers of Commerce, Professional Institutes and individuals.

I am pleased to place on record the valuable contribution provided by the learned Members of the Study Group despite their busy schedules achieving a commendable task to bring out in report within a very short frame of time. I would also like to commend Shri A. Ramaswamy for effectively coordinating the meetings and ensuring its completion within the scheduled time frame.
There can not be two views on the urgent need to establishing an independent autonomous Center to be called **Centre for Corporate Excellence** in the country. The Department of Company Affairs as the nodal authority concerned with the administration and management of the corporate sector should take the necessary initiatives to set up this Centre. Hopefully, the proposed Centre would develop as a Premier Institution on the subject for SAARC and countries in the Asia Pacific region and emerge as a model and marvel meeting the long felt need of the entire Corporate sector.

\[Sd/-\]

(Dr. P.L. Sanjeev Reddy)

Chairman
ORDER

The Central Government hereby constitutes a Study Group consisting of the following to examine to operationalise the concept of corporate excellence on a sustained basis to sharpen India's global competitive edge and to further develop corporate culture in the country.

1. Shri PL Sanjeev Reddy, Secretary Department of Company Affairs Chairman
2. Shri Kumarmanglam Birla, Chairman Aditya Birla Group Member
3. Shri M.R. Rao, Director, Indian Institute of Management Bangalore Member
4. Shri NH Mirza C/O SR Batliboi & Co. Member
5. Shri PM Narielvala Member
6. Dr. MB Athreya Management Adviser Member
7. Shri Maninarayan Swami Adviser, UB Group of Companies Member
8. Shri Mukesh Ambani Vice-Chairman and MD Reliance Industries Ltd. Member
9. Shri Rajiv Chandrasekhar CMD, BPL, Telecom Centre Member
To
1. All Members of the Committee
2. Sr. PPS to Secretary
3. PS to Minister/Minister of State for Law, Justice and Company Affairs
4. All Officers and Sections in the Department.

(vi)
To

All Members,

Subject: - Centre for Corporate Excellence-Formation of a task force.

Sir,

In the first meeting of the Study Group on Corporate Excellence held on 9th May, 2000 in New Delhi, it was decided to constitute a small task force as under:-

- Shri S. Rajagopalan, Chairman, MTNL - Chairman
- Shri J. Sridhar, President, ICSI - Member
- Shri MR Rao, Director, IIM, Bangalore - Member
- Shri PM Narielvala, Chartered Accountant, Calcutta - Member

The task force had been requested to submit its report suggesting an effective action plan with a view to operationalise the concept of corporate excellence and to improve India's global competitiveness and development of corporate culture. The task force has been requested to submit its report within 30 days and it can co-opt any expert in the field/person, if need be.

2. The report submitted by the said task force will be taken up for discussion in the next meeting of the Study Group.

Sd/-

( R.N. Vaswani)

UNDER SECRETARY TO THE GOVERNMENT OF INDIA

Tel. No. 3389622

* Prof. N. Balasubramanian, IIM, Bangalore was co-opted as Member of Task Force

(vii)
Prefatory Note

Post-Independence India has witnessed a very impressive growth of the corporate sector. It is reported that an amazing number of over 5.3 lakhs companies with capital of about Rs.272865 crores were at work in the country as on First January 2000. This prime sector of the economy has also contributed significantly to the economic growth of the country in general and the general well-being of the Society. That, the Government also attaches great importance to the corporate sector is evident from the frequent exercises undertaken by it to bring about refreshing changes in the way in which the corporate enterprises function by amending the Companies Act, the principal legislation governing the companies to bring about simplification and also to keep pace with the developments taking place the world over. However, in spite of all these efforts a disquieting feature of the corporate growth has been the increasing incidences of vanishing companies, mismanagement, oppression, widespread shareholder dissatisfaction and unethical business practices. The last decade also witnessed the unearthing of several scams considerably damaging the reputation of Indian corporates. Here lies the answer to the nagging question as to why corporate governance or why excellence. No one would like to deal with tainted companies, definitely not the foreign investors and collaborators. Accordingly the Government had initiated measures both legislative as well as ameliorative, to arrest the further deterioration in the functioning of corporate sector as also to heal the damage caused.

The Department of Company Affairs in the Ministry of Law, Justice and Company Affairs, Government of India, being the sort of Alma Mater of corporates, and responsible for administering the working of companies as also the Companies Act, has been working vigorously in the direction of putting in place an altogether new company law to suit the modern requirements. The Department has also been vigorously trying to streamline the working of companies. The recent one-time Company Law Settlement Scheme 2000 to give an opportunity to defaulting companies to file their returns and documents as also the Fast Track Section 560 scheme announced by it are significant
measures to reform the corporates' functioning. The Department is also very much determined to inculcate a high degree of ethics in the corporate functioning. Along with the efforts of SEBI to frame a set of corporate governance practices in the form of a corporate code by appointing the Kumar Mangalam Birla Committee and adopting and implementing some of its recommendations swiftly, the Department has gone a step further to transplant the concept of corporate excellence through corporate governance as the ultimate Benchmark for corporates. ‘Excellence’ is no longer desirable but necessary in today’s environment in whatever we do; corporates are no exception. With the opening up of the economy and to be in tune with the WTO requirements, if Indian corporates have to survive and succeed amidst increasing competition from transnationals and foreign corporates and it can only be through achieving ‘Excellence’ in their working. Excellence in terms of administration, excellence in terms of the end product or service, excellence in terms of investor return, excellence in terms of social responsibilities, excellence in terms of returns to the promoters, and excellence in terms of rewards to the people who run the corporates including workers. ‘Destination India’ is not confined to attracting foreigners for holidaying in India, but it is also for foreign investors for parking their funds in India and to share their know how and technology with India in order to create wealth.

Towards this direction of achieving excellence, in May, 2000 the Department invited a group of leading industrialists, professionals, and academics to study and recommend measures to enhance corporate excellence in India. This study group was formally constituted by Order No.11/6/2000 CL.V dated 15th May, 2000 essentially to operationalise the concept of corporate excellence on a sustained basis. The composition of the Study Group is as under:

Chairman
Dr P L Sanjeev Reddy
Secretary, Department of Company Affairs
### Members

1. **Shri Kumar Mangalam Birla**  
   Chairman, Aditya Birla Group

2. **Shri M R Rao**  
   Director, Indian Institute of Management Bangalore

3. **Shri N H Mirza**  
   C/o S R Batliboi and Company

4. **Shri P.M Narivelala**  
   Former Sr. Partner, S R Batliboi & Company  
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5. **Dr M B Athreya**  
   Management Adviser, New Delhi

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7. **Shri Mukesh Ambani**  
   Vice-Chairman and MD  
   Reliance Industries Limited

8. **Shri Rajiv Chandrasekhar**  
   CMD, BPL Telecom Centre

9. **Shri A Ramaswamy**  
   Joint Secretary, Department of Company Affairs

10. **Shri S Rajagopalan**  
    Former Chairman, MTNL, New Delhi

11. **Shri G Sitharaman**  
    President, The Institute of Chartered Accountants of India  
    New Delhi

12. **Shri J Sridhar**  
    President, The Institute of Company Secretaries of India  
    New Delhi and Controller of Finance & Company Secretary  
    Maharashtra Scooters Limited, Pune
The Task Force met twice in Bangalore on 5th June, 2000 and 21st August, 2000 and twice at Delhi on 8th November and 15th November, 2000. The first discussion draft of the report was deliberated and a further draft was circulated to its members on 19th September 2000. Further refinements were brought in on the basis of discussion at the meeting held on 8th November the revised draft was circulated to members on 15th November 2000. Further discussion and further refinements are manifested in the present format of the Report.

Dr N Balasubramanian, Visiting Professor, Indian Institute of Management, Bangalore was subsequently co-opted as a Member of the Task Force on 5th June, 2000.

The Task Force was mandated to suggest an effective action plan with a view to operationalise the concept of corporate excellence and to improve India’s global competitiveness and development of corporate culture in India.

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Chairman

Shri S Rajagopalan

Members

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Shri M R Rao
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‘Excellence’ being a term which eludes precise definition, the Task Force’s task was indeed a bit complicated, but thanks to the wisdom of the members and the fruitful incisive and analytical meeting-of-the minds and the resulting contributions of the intellect of the members, my task was made rather easy. I personally owe a deep sense of gratitude for the immense contribution and cooperation of all the members. They not only made themselves available at short notice notwithstanding their personal inconveniences and official pre-occupations but also contributed enormously through their positive and constructive suggestions. I am indeed beholden to Shri P M Narielvala who, inspite of his very busy schedule contributed immensely not only through personal discussions but also followed it with repeated e-mails with further suggestions and ideas. I was indeed overwhelmed by his serious concern and deep involvement. The Report in the present form has substantial value addition made by Shri Narielvala. I am beholden equally to Dr N Balasubramanian, the co-opted member, on whom the responsibility of preparing the first draft and progressing it through to the final version fell since the first two meetings were held at Bangalore. Dr Balasubramanian, willingly and pleasingly undertook the task and admiringly did a commendable job with the speed of light. But for the mature wisdom of Dr Rao, the report would have been wanting in many respects. To Shri J Sridhar, dynamic President of the Institute of Company Secretaries of India I have no words of appreciation. In fact when the meetings were held at Delhi, he made his presence in spite of having the responsibility of chairing a very crucial and important meeting of the ICSI. His open minded approach and ever smiling attitude and his erudite discussions on various complicated aspects of company law, did make my burden very light. The Task Force also places on record the valuable ideas given by Dr P L Sanjeev Reddy, Secretary, Deptt. of Company Affairs and Shri A Ramaswamy, Joint Secretary, Deptt. of Company Affairs during discussions held on 8th and 15th November, 2000. The Task Force is also pleased to place on record the valuable contribution made by Shri V Gopalan, Director (Publications), Institute of Company Secretaries of India. To the Secretary of the Institute of Company Secretaries of India, Dr S P Narang, the Task Force owes a deep gratitude for making available its facilities for holding the meetings and also for sparing required manpower without which it would not have been possible for the
With this introductory I am privileged to commend this Report to the Study Group constituted by the Department for further deliberations and adoption as deemed fit.

No doubt the Task Force firmly believes that corporate governance should not be an imposition but a necessity and advantage to cope with highly competitive pressures of today's economy. At the same the Task Force feels that to begin with, however, there has to be some amount of compulsion for corporate entrepreneurs to adopt a code of best business practices. The Task Force earnestly hopes that its recommendations contained in this report would lead to the Government interacting with other professional bodies in order to evolve an ideal corporate code of governance for the Indian corporates.

With this introductory I am privileged to commend this Report to the Study Group constituted by the Department for further deliberations and adoption as deemed fit.

New Delhi
20th November 2000

Sd/-
S RAJAGOPALAN
Chairman
The role of the corporate board of directors as stewards of their shareholders and stakeholders has internationally gained significant ground in recent decades. Successive corporate failures and other disasters have strengthened the demand for more transparency and accountability on the part of corporations. In the discharge of these onerous responsibilities, the corporate board has come to be regarded as the principal arbiter, ensuring on the one hand that executive management competently and through legitimate means creates wealth, and on the other, that such created wealth is equitably distributed to all shareholders after meeting the due aspirations of and obligations to other stakeholders. This requirement applies equally to cases of extreme separation of

Report of the Task Force
On
Corporate Excellence through Governance

Executive Summary

A major contributory to corporate excellence is good corporate governance. In well developed, competitive and globalised economies, there is strong evidence to suggest that corporations well known for their high standards of transparency, accountability, professionalism, social responsiveness, corporate citizenship, and ethical business practices, in short, for good corporate governance, are also those which deliver excellent returns to their shareholders and are admired by their stakeholders and society at large. In the short decade that India has grappled with the challenges posed, and capitalised on the opportunities offered by a liberalising economic environment, there are already shining examples of corporations achieving business excellence concurrently with, or perhaps more appropriately, because of the excellent standards of corporate governance that they have set for themselves. Further maturation of the market place is likely to recognise and reward such corporations in greater measure in the decades ahead.

Role and Responsibilities of Corporate Boards and Directors

The role of the corporate board of directors as stewards of their shareholders and stakeholders has internationally gained significant ground in recent decades. Successive corporate failures and other disasters have strengthened the demand for more transparency and accountability on the part of corporations. In the discharge of these onerous responsibilities, the corporate board has come to be regarded as the principal arbiter, ensuring on the one hand that executive management competently and through legitimate means creates wealth, and on the other, that such created wealth is equitably distributed to all shareholders after meeting the due aspirations of and obligations to other stakeholders. This requirement applies equally to cases of extreme separation of
It is imperative to distinguish the nature of the two basic components of governance in terms of policy making and oversight responsibilities of the board of directors, and the executive and implementation responsibilities of corporate management comprising of the managing director and his or her team of executives including functional directors. Executives who are also on the board as directors of the company in effect wear two hats, one as part of the board and the other as part of the management. Directors derive their authority only when acting collectively as the board or when the board delegates specifically authorities to be exercised, such as for example in the case of managing directors. Managers, in the broadest sense of the term, have the responsibility to execute the policies under the supervision of the board, and for this purpose have the necessary authority to ensure compliance and implementation. The Task Force highlights this critical distinction particularly in the context of fixing responsibility for failure and the consequential liabilities that follow.

**Direction and Management Distinguished**

It is imperative to distinguish the nature of the two basic components of governance in operational control from share ownership and those with dominant shareholders in charge of executive management as is the case in several developing countries. Hence the perceived need for the board to be independent of the executive, which position is sought to be achieved by infusion of a majority of competent non-executive directors with no material pecuniary relationships with the corporation or its opinion-makers. The Task Force recommendation in this field calls for a greater role and influence for non-executive independent directors, a tighter delineation of independence criteria and minimisation of interest-conflict potential, and some stringent punitive punishments for executive directors of companies failing to comply with listing and other requirements. Legal validation of electronic conferencing and other such measures to facilitate greater board participation, and attendance/participation by a majority of independent directors as a statutory quorum requirement for board meetings are further measures recommended. The position and status of nominee directors have also been addressed in the recommendations.
Managing & Whole-Time Directors

Managing and other whole time directors are required to devote whole or substantially whole of their time to the affairs of their companies. And yet, many of them serve as non-executive directors on several other boards. The Task Force felt that the shareholders and stakeholders of the company appointing them as their executives should have the benefit of their full attention and accordingly, has suggested some limitations on the nature and number of their other directorships.

Non-Compete Stipulations

Should executive directors and dominant shareholders have the freedom to compete with the companies in their material lines of business? Equity demands that they should not, and at any rate, even if they are permitted to, the Task Force opined and has accordingly recommended that there should be proper disclosure to the shareholders and the investing community.

"Interested Shareholders"

Shareholder democracy, like many other lofty principles of fair play and public policy, is often supported more in precept than observed in practice. In order to strengthen the democratic rights of minority shareholders, it may be desirable that matters directly affecting their interests are decided upon exclusively by them without brute majority of numbers having full sway. Accordingly, one of the most important recommendations of the Task Force is proposes the concept of interested shareholders who would be required to abstain from voting on specified matters that impact upon some but not all the shareholders. This is somewhat analogous to, but not the same as, the principle of interested directors being required (as part of their fiduciary responsibility) not to participate in or vote upon resolutions they are interested in. Conscious of the potential of such a measure being abused, the Task Force has recommended that this privilege be
limited to a few specific matters and even there with suitable provisions for breaking stalemate situations.

**Measures Promoting Transparency and Informed Shareholder Participation**

A related issue of equal importance is the need to bring about greater levels of informed attendance and meaningful participation by shareholders in matters relating to their companies, without however such freedom being abused to interfere with management decisions. The Task Force recommendations addressing this issue relate to more meaningful and transparent accounting and reporting, improved annual reports concomitant with more detailed filing with regulatory authorities, and greater facilitation for informed participation using the advances in converging information and communications technologies.

**National Listing Authority**

Listing of companies on stock exchanges is seen by unwary investors as some kind of qualitative *rating* of the company, despite disclaimers to the contrary. The Task Force recommendations recognise this important signaling effect of Listing, and provide for tougher Listing and compliance regimen through a centralised National Listing Authority. This is also intended to remove the dependence of some of the less active stock exchanges, on Listing fees as a principal source of their income, leaving them to promote and survive upon transactions based revenues.

**Measures Relating to Listing & Voluntary De-Listing**

As a measure of investor protection and general upgrading of the status of Listed companies both internationally and domestically, the Task Force recommendations apply the highest and toughest standards of corporate governance to Listed companies. To take care of legacy companies not in a position to fall in line, an exit route for such companies with due protection to current investors is recommended. It is
better to have fewer but better and excellent Listed companies than to have several thousands that have neither the intention nor the capability to reach levels of excellence in this field.

**Public Sector Enterprises**

State owned enterprises with public and institutional shareholdings (and their number is only likely to increase with growing privatisation and disinvestment programmes currently pursued by the government) have to be unshackled from several handicaps that can restrict their entrepreneurial and risk-taking capabilities if they are to be run like and compete with other private sector companies. At the same time, there is a case for prescribing a code of behaviour for public sector units and their employees. The Task Force has recommended that such PSUs be relieved from multiple surveillance agencies and simultaneously a commission be appointed to draft a suitable code of public behaviour on the lines of the Nolan (now Neil) Commission in the United Kingdom. As a beneficial fall out, this would also provide some acceptable standards for the civil service and the government, and perhaps to political offices too.

**Corporate Social Responsibility**

Accountability to stakeholders is a continuing topic of divergent views in corporate governance debates. In line with the developing trends towards an integrated model of governance, the Task Force recommendations emphasise corporate social responsiveness and ethical business practices, seeking what might well turn out to be not only the first small steps for better governance on this front but also the promise of a more transparent and internationally respected Corporate India of the future.

**Centre for Corporate Excellence**

Given the imperatives of improving standards of corporate governance to enhance the competitive capabilities of Indian corporations on the one hand, and on the other of
Classification of Recommendations & Implementation

Recommendations of the Task Force have been grouped as essential, to be introduced immediately by legislation, and desirable, that can be left to the discretion of the companies and their shareholders in their wisdom. A model governance code incorporating both the essential and desirable measures has been recommended to be drafted and included as a Table in the Companies Act, to be adopted at the option of the companies. Given the challenges of managing change, the Task Force has recommended phased implementation of the essential measures, depending upon the size and capabilities of the companies on the one hand and on the other, the requirements of the market place.
Internationally, a growing school of influential thinkers advocate that corporate governance measures should be more by self discipline and market forces, rather than by legislation and regulation. This of course is unexceptionable and deserves full support. The Task Force is however convinced that the level of non-legislative and non-regulatory intervention is a function of the maturity of the market and the economy. Until acceptable levels of such maturity and market influence are reached, it may be necessary to support self discipline and self regulation with appropriate legislative and regulatory support with a provision for review after three years. However, emphasis continue to be on self regulation. The desire for self-regulation should be enhanced by a recognition of the advantages of good governance in improving the company's credibility and market acceptance.

The earlier reluctance to adopt self regulatory measures was partly due to the licence and permit system which reduced the effect of competitive forces. With competition now becoming a powerful force in the market there should be increased recognition of the advantages of good corporate governance. The recognition should be supported by education, promotion and propagation.
Part I
Corporate Governance in India: A Status Report

"A little neglect may breed great mischief ... for the want of a nail, the shoe was lost; for the want of a shoe, the horse was lost and for the want of a horse, the rider was lost and for the want of a rider the war was lost".

-BENJAMIN FRANKLIN

1.1 Little neglects add up to mischiefs and mischiefs ultimately lead to bigger frauds and scams and corporate enterprises are no exception. Care enables to avoid little neglects; more care helps to avoid mischiefs and greater care adds up to establish good governance which ultimately leads to Excellence.

1.2 Corporate governance issues have attracted considerable attention, debate, and research world wide in recent decades. Almost invariably, such efforts gain momentum in the wake of some major financial scam or corporate failure, as these tend to highlight the need for tighter surveillance over corporate behaviour. Corporate governance has wide ramifications and extends beyond good corporate performance and financial propriety though these are no doubt essential.

1.3 The basic rationale for high standards of corporate governance stems from the inherent characteristics of the corporate form of organisation. Given the growth in the size of equity requirements, joint stock companies are obliged to raise required capital from a large number of shareholders. Other than those in control of the operations of the company, shareholders cannot (and should not) have any active participatory role in the management of the organisation. In very large corporations with vastly dispersed shareholdings, the executive is all-powerful in matters relating to the management of the affairs of the company. While there is general agreement that the principal objective of corporations is to maximise shareholders wealth, there is always a nagging suspicion (often, regrettably, justified in practice) that the executive may siphon off some part of
the created wealth through excessive rewards to themselves, and thus deny transmission of all created wealth to its rightful owners, the shareholders. The Board of Directors in a company is vested with the responsibility of stewardship and surveillance over the affairs of the corporation, no doubt acting through the executive but ensuring that the executive does not appropriate to itself a larger than due slice of the shareholder wealth cake.

1.4 While this structure is obviously most relevant in situations of extreme separation of ownership from control, its application to other cases where such separation may be less severe, with a dominant shareholding group in control, is even more critical and should not be underestimated. The difference in the latter case is that the rest of the shareholders' interests need to be safeguarded from possible undue diversion of created wealth not just to the executive but also to the dominant shareholding or controlling group. The situation is not very different in case of state owned enterprises that have some shareholding in the hands of institutional and other retail investors, with the bureaucracy and/or strategic partners in control, and in a position to influence wealth distribution through political patronage or other administrative means. It is in this context that the need to have independent boards of directors becomes highly imperative.

1.5 Good corporate governance is the key to efficiency in a competitive environment. In this corporate governance provides a cutting edge. Good corporate governance is not merely desirable but it is essential for survival. It is necessary not just because it is good for the shareholders and other stakeholders, it is essential because it is in the interest of the company itself in the present competitive environment. It is good for the shareholders because it is good for the company on which their future depends. Good corporate governance should of course emphasise ethicality. Decision making processes should be transparent, consistent with the need to protect the competitive interests of the company as otherwise shareholders and other stakeholders in the enterprise would lose out.

1.6 Internationally, corporate governance norms have been initiated through a judicious mix of the three available routes: legislation, regulation, or self-discipline and free volition. Often, a fourth driver is also evident in the form of societal pressures. In
1.7 In India, company legislation has until recently been the main instrument for improving corporate governance. Tracing its origins to the mid-nineteenth century, and thereafter closely following similar developments in the United Kingdom, the Companies Act 1956 was a consolidating legislation of monumental proportions and far reaching impact that significantly altered the structure of corporate management in India. Subsequently incorporating the recommendations of the Bhabha Committee, this Act legislated, among other things, the abolition of the system of managing agencies, an institution that had served the country truly and well during the early days of corporatisation, but fallen into disrepute through abuse and malpractice in its application by its latter day exponents. With this, a pernicious vehicle for siphoning off corporate wealth for the benefit of a few dominant and controlling shareholders was sought to be destroyed. Subsequent amendments in the later part of the twentieth century essentially built upon the basic 1956 edifice, and usually attempted to plug observed loopholes in practice. A completely revised, updated, and in-tune-with-the-times, abridged version of the legislation that was introduced in parliament some years ago is yet to be approved, but more urgent and necessary revisions to meet the requirements of a changing business environment were enacted through an amendment in 1999. Another Amending Bill
introduced in late 1999 and modified in 2000 has recently been approved by Parliament and is awaiting Presidential assent. This report aims to offer further inputs for improving standards of corporate governance in the country.

1.8 Governance initiatives through regulation have also made significant strides in the country. The Securities and Exchange Board of India (SEBI) has an ongoing programme of reforming the primary and secondary capital markets. The Stock Exchanges in the country also mandate several salutary requirements through their Listing Agreements that every publicly traded company has to comply with. Among the professions, The Institute of Chartered Accountants of India has emerged as a mature body regulating the profession of public auditors, and counts among its achievements the issue of a number of accounting and auditing standards. Constitution of an independent National Advisory Committee on Accounting Standards has been legislated by the amending Act of 1999. Other professional bodies such as the Institute of Cost and Works Accountants of India and the Institute of Company Secretaries of India have helped in promoting and regulating a well trained and disciplined body of professionals who could add value to corporations in improving their management practices. The Institute of Company Secretaries of India has also taken a major initiative in constituting a Secretarial Standards Board comprising senior members of eminence to formulate secretarial standards and best secretarial practices and develop guidance notes in order to integrate, consolidate, harmonise and standardise the prevalent diverse practices with the ultimate objective of promoting better corporate practices and improved corporate governance.

1.9 Self-regulation has been somewhat lagging behind in the area of corporate governance in the country. While, admittedly, some of the Indian companies compare most favourably with the best elsewhere in the world in the field of professional management and corporate governance, the vast majority has been languishing with outdated practices nurtured during the years of insulated economic environment that obtained in the country for the better part of its post-independence history. The liberalisation initiatives of the nineties have exposed the inefficiencies of many of these
organisations which are trying to come to terms with the paradigm shift in doing business.

1.10 Changing with the times, industry associations have taken the initiative to come up with guidelines for their member companies in the area of governance. A formal effort was initiated by the Confederation of Indian Industry (CII) when it produced in 1998 a document titled “Corporate Governance - A Desirable Code” through a Task Force headed by Shri Rahul Bajaj, that probably for the first time formally recognised the obligation of listed corporations to create corporate wealth and distribute it among all their shareholders. The need for transparency in reporting and the imperatives of having independent non-executive directors who could protect the interests of shareholders were clearly articulated. This document is currently under revision to incorporate improvements.

1.11 A similar initiative was mounted by SEBI with the constitution of a committee (KMB) under the chairmanship of Shri Kumar Mangalam Birla. Its report recommending guidelines on corporate governance published in February 2000 is a well balanced compendium of good practices that will stand corporates in good stead in their governance-improvement endeavours. Some of these recommendations however have been categorised as mandatory, and have since been incorporated in the Listing Agreements of the Stock Exchanges. To this extent, this initiative may be termed part-regulatory, part-voluntary. It may only be a matter of time before many of its other recommendations become mandatory regulations.

1.12 Further initiatives in this field are underway. For example, the Reserve Bank of India has appointed a Committee to report on governance requirements specific to banks and financial institutions. The constitution by the Department of Company Affairs (DCA) of a Study Group to report on improving corporate excellence through governance is also in itself a further initiative in the direction of enhancing the corporate image of India. DCA is currently engaged in the exciting task of enabling Indian companies to excel in a globally competitive market, create wealth for the shareholders and to the Nation by
promoting an investor friendly environment. The Company Law Advisory Committee chaired by Dr P L Sajeev Reddy, Secretary, Department of Company Affairs is constantly reviewing the needs of corporate sector and its constituents for encouraging better corporate governance. It will also facilitate adoption of best practices and suggest new benchmarks for better corporate performance. Highly proactive and progressive in accepting the challenges of change, DCA is encouraging innovations in corporate governance and state of the art technologies to create wealth, enhance shareholders value, increase transparency, promote accountability, ensure investor protection and facilitate corporate excellence.

1.13 It is a matter of satisfaction that several companies have already begun adopting many of the desirable corporate governance practices, especially in reporting ahead of stipulated time, thanks to such sustained efforts of the Government and of course also to the impact of globalisation in accessing international markets for their capital requirements. With the Listing Agreement mandating compliance of some of the KMB recommendations over on a phased time schedule, more companies will fall in line before March 2001. All those seeking listing for the first time will, irrespective of their size, have to fall in line immediately. One can therefore expect a much more visible movement towards implementing such practices in the years ahead, though it remains to be seen whether the KMB’s exhortation that these should become "a way of life" would be fully heeded by all corporations in the short run.

1.14 A lot more remains to be done. Numerous reports and studies across the world testify to this pressing need. In the United Kingdom, while the pioneering foundations for improving corporate governance were laid by the Cadbury Report in 1992, it was followed by further extensions and revisions brought about by the Hampel Committee, the Greenbury Report, the Combined Code, and more recently the Turnbull Report. In the United States, the early nineties saw the publication of the Treadway Commission Report of the Committee of Sponsoring Organisations. It is indeed quite revealing that in a country where, for example, Audit Committees were mandated by the New York Stock Exchange as early as in 1973, a Blue Ribbon report in 1999 was found necessary to
explore ways of improving the effectiveness of Audit Committees. Canadian initiatives on corporate governance spearheaded by the Toronto Stock Exchange, led to the publication in 1994 of the provocatively titled report, “Where were the Directors?”, which was itself the subject of a 1999 review of compliance and implementation in *Five Years to the Day*, appropriately named after the chair of the earlier 1994 committee. Similar is the experience in many other countries where there is a felt need for ongoing review and updation of the requirements. A brief outline of overseas developments on governance issues is set out in the Appendix - I.

1.15 The existing diversity and complexity of forms of corporate enterprises and patterns of corporate governance will continue and, very probably, increase. Alternative paradigms of corporate governance will be needed to improve the effectiveness of governance, to influence the healthy development of corporate regulation, and to understand the reality of the political processes by which companies are governed, rather than the structures and mechanisms through which governance is exercised. In any development, it will be important to avoid the polarities of governance based on an expensive bureaucracy of regulation and the adversarial clash of vested interests. Governance powers and processes need to provide for several different constitutional bases of modern enterprise and to reflect the reality of power over that entity, balancing independence and objectivity with executive commitment and motivation.

1.16 The message is clear. None of the corporate governance principles can be cast in stone and laid to rest forever. There is an ongoing need for constant review and course corrections that would keep the country in the pink of health in terms of its corporate excellence. By a judicious mix of legislation, regulation, and suasion, this task needs to be addressed. With growing maturity and competitive compulsions, it should be possible to gradually reduce legislative interventions and increase regulatory compliance with, and self-induced adherence to, the best practices in this field. Till then, however, legislation to ensure at least certain minimum standard is inevitable.
Globalisation has opened up an array of opportunities to corporate India. To emerge successful in its new tryst with destiny, there are no soft options available and the Indian corporate sector must necessarily turn to good governance in its pursuit of competitive excellence in a challenging international business environment.
2.1 Best practices in the field of corporate governance may broadly be grouped under four categories: those relating to corporate boards and directors, those concerning operational management and control, those dealing with credibility and transparency of reporting, and those bearing upon shareholder democracy and minority protection. The current position as recommended by industry bodies, mandated by regulators, and legislated by existing law is reviewed in this part, suitably drawing upon international experience where appropriate, pointing to potential areas for further improvement. A separate section highlights certain issues unique to listed public sector corporations, in the field of governance. The concluding sections of this Part deal with the need for a National Listing Authority and a one-time Voluntary De-listing Scheme.

Corporate Boards and Directors

2.2 Reference has already been made to the critical positioning of the Board of Directors in the corporate form of organisation. In the United Kingdom, the Cadbury Report placed the corporate board at the centre stage of the governance system which it described as one by which companies are directed and governed. Given the fiduciary relationships that corporate directors are subject to, there is an overwhelming need to ensure that they discharge their responsibilities to the best of their abilities to protect and promote the interests of all shareholders. At the same time, there is also a pressing need to delineate the directing and managing aspects of governance. It is in this perspective that the role, responsibility and accountability, constitution, structure, independence,
competence, remuneration, empowerment, and evaluation of corporate boards and their directors needs to be considered.

**Role, Responsibility and Accountability**

2.3 Despite the increasing focus on board accountability and contribution, there is no doubt that the board's role is to direct the affairs of the company and its responsibility is to exercise oversight control such that the wealth and wealth-creating assets of the company are protected. Arguably the most extensive and far-reaching delineation of board responsibilities is to be found in the Canadian guidelines of 1994, which identify five specific components of the board's stewardship responsibilities. These are: adoption of a strategic planning process, management of risk, appointment, training, and monitoring of senior management, effective communication, and ensuring the integrity of corporate internal control and management information systems. None of this of course implies that the board itself has to take hands-on responsibility in preparing strategic plans or implementing appropriate internal controls and so on, which are all the function of the chief executive and his operating team. But clearly, it is the responsibility of the board to see that appropriate systems and processes are in place that would ensure and facilitate and monitor the discharge of these responsibilities.

2.4 The Cadbury Report in 1992 described the board responsibility in more succinct phraseology, to include setting the company's strategic aims, providing the leadership to put them into effect, supervising the management of the business, and reporting to shareholders on their stewardship. The KMB Report describes this role as providing leadership and strategic guidance, objective and independent judgement, and control over the company in the discharge of its accountability to the shareholders. Direction, control, and accountability are the three prongs of board responsibility as observed by the KMB Report.

2.5 The distinction between *direction* (which is the responsibility of the board) and *management* (which is the responsibility of executive management including the managing director and other directors in their role as executives) is often not as clearly
perceived as it ought to be. The KMB report has done well to articulate some of the roles of executive management as distinct from the responsibilities of the board. Company law as it stands currently does not bring out this distinction clearly and needs an appropriate modification, to highlight the boards' responsibility as being to *supervise the management of the business*.

2.6 While accountability to the shareholders and creation of wealth for them are seen as central to the corporate governance debate, there is no denying the board's accountability to the company's stakeholders as well. Prominent among the advocacy of stakeholder rights is the 1995 work of Margaret Blair in which she rejects the traditional *residual claimants* theory supporting shareholder primacy, and postulates the rights of employees in particular where their firm-specific investments may be more important in the wealth creation process than the financial resources provided by the shareholders. Many other economists have from time to time espoused the cause of other stakeholders like customers, community, vendors, and so on. Thus the basic objective of good governance should be legally and ethically optimising a sustainable return on the investment and ensuring its fair and equitable distribution among all legitimate stakeholders.

2.7 Modern governance codes tend to tread a cautious middle path. While shareholder wealth creation is still the focus, stakeholder interests also need to be protected. The 1998 OECD document on corporate governance authored by Mr. Ira Millstein and five others including Sir Adrian Cadbury observes that while acknowledging the primary objective of corporations in market economies as generating economic profit so as to enhance shareholder value in the long term, corporate governance must simultaneously fulfil broader economic, social and other national objectives. Nearer home, the KMB Report postulates that the primary objective of corporate governance is the enhancement of shareholder value, keeping in view the interests of other stakeholders.

2.8 The board's role then is to steer a clear course in driving shareholder wealth creation and protection. In pursuing this goal, relationships with stakeholders need to be
managed such that their interests are also taken care of. This is indeed a complex scenario, particularly when such competing interests are not goal-congruent. Boards may often be seen pursuing a policy of hunting with the hounds and running with the hares, but in fact this need not be so in a large majority of situations. In cases where shareholders' interests are threatened, boards will have to move in to protect them to the extent they can.

2.9 While on the subject of stakeholders and the board's fiduciary responsibilities to the shareholders, it may be useful to note that in some countries special provisions are enacted to ensure that company boards consider the interests of stakeholders as well, besides shareholders. Thus for example, in the United States, several states have enacted "other constituencies" legislation to ensure stakeholders' interests are not entirely sacrificed at the altar of shareholder primacy. It will however be advisable to proceed with caution in this regard, as many of these provisions appear to have created more problems in interpretation than they have solved.

2.10 As mentioned earlier, *directing* and *managing* are often interchangeably used in literature and even legislation. And yet, the two functions are quite distinct and belong respectively to the domains of the Board and the Executive. It is in this context that the Canadian guidelines draw attention to the fact that corporate boards can only "supervise, direct or oversee" but certainly can not "manage" at least in a day-to-day sense, and have called for a revision in corporate legislation to define board responsibility as being "to supervise the management of the business". This position is in fact recognised in Indian law, though in a contextually different situation, where the Managing Director (meaning the Chief Executive) is defined to have been entrusted with "substantial powers of management" and the exercise of such powers being "subject to the superintendence, control and direction of its Board of Directors" [Emphasis supplied]. Despite such recognition of the distinction, however, company legislation in the country continues to deal with the two functions in a somewhat common manner, as for example, directors' remuneration being broadly covered under *managerial remuneration*, and several matters dealing with the Board and the directors being grouped under a broad chapter heading
2.11 The KMB Report has done well to highlight these distinctions by defining the board's responsibilities as relating to direction, control and accountability, and those of the executive or management as relating to maximisation of shareholder value without detriment to other stakeholder interests. A detailed listing of management functions in the Report also helps to further clarify the differing roles of the board and directors on the one hand, and the executive management on the other.

2.12 Following from this role-clarification, compliance and default provisions in various statutes and regulations including those in company legislation may have to be revisited. At a fundamental level, direction has a predominantly policy and oversight orientation which relates more to the realms of formulation and implementation of strategy and achievement of results within a laid down legal and ethical framework. The Task Force strongly believes that non-executive directors can contribute significantly to the success of their companies through effective and yet non-invasive participation in deliberations bearing upon their affairs. To extend this scope to cover interventions in the management of the company is tantamount to taking away the very essence of the institution of independent non-executive directors in the governance structure of corporations.

**Composition**

2.13 Indian company law prescribes a minimum of three directors for a public limited company. Subject to this requirement, the size of the board is left to the company itself. Neither the CII Code nor the KMB Report makes any reference to this point. International practice also tends to leave the size issue for determination by the company.
2.14 What is perhaps more important than absolute size is the composition of the board of directors in terms of their ability to discharge their responsibilities in the interests of all shareholders. For reasons already discussed, there is a growing international trend towards independent non-executive boards. Following this movement, and given India's own progression towards improved capital markets, both the CII Code and the KMB Report dwell at length on this aspect. Through the Listing Agreement route, listed companies are now required to have at least fifty percent of the board as non-executive. Recognising this trend the Task Force suggests that there should be a minimum of five directors for all listed companies.

2.15 Elsewhere in the developed world, non-executive directors, largely, are by definition also independent but the Listing Agreements (following the KMB Report) make a distinction between independent and non-independent non-executive directors. In the case of a company with a non-executive chair, at least one-third, and in other cases at least one half, of the board are required to be independent. Independence is defined to exclude (other than remuneration as a director) any material pecuniary relationship or transactions with the company, its promoters, its management, or its subsidiaries, which in the opinion of the board may affect independence of judgement of the concerned director. Presumably, this distinction is a transitional provision to tide over practical difficulties in transforming overnight company boards into a binary executive / independent non-executive format, but neither the KMB Report nor the Listing Agreements provide any timeframe for review of this position.

2.16 The definition of independence, even though somewhat less rigorous than some of the corresponding criteria doing the rounds elsewhere, is still far-reaching in its import. A strict interpretation may rule out most of the consultants, lawyers and public accountants, employees of promoters (including individuals, groups, holding companies, and so on), besides representatives of other stakeholders like company employees (workers' representatives on the board for example), key vendors and customers. While this may be a salutary and welcome position to ensure a measure of objectivity in board decisions, its practical application may be beset with problems of inability to "accommodate" certain
family or group aspirations on the one hand, and on the other the likely paucity of competent non-executive directors who can still qualify as independent.

2.17 A safety valve provision has been made probably to mitigate the immediate harshness of the situation, by the discretion vested in the board to decide in specific instances whether any such pecuniary relationships are reason enough to impair exercise of independent judgement. In order that this discretionary route is not resorted to as an easy way out of an otherwise ticklish problem, the board should perhaps have been asked to disclose their justification for overriding the independence criteria in specific cases.

2.18 The case for a majority of independent directors is equally valid in public sector corporations with external institutional and other retail shareholders. The Union Government has been alive to this need and has already inducted such independent directors on several such boards. Given the significant stakeholder issues involved, there is a case for extending this initiative to other state owned enterprises and institutions, with or without external share ownership, both at the central and, perhaps more importantly, at the state levels.

2.19 The influence of outside directors on the corporate governance is a matter of board structure and process, but ultimately it depends on the persons concerned so appointed. The non-executive directors are as responsible for the company's progress and success as their executive colleagues. The non-executive directors can play an important role in the formulation of company's strategies and monitoring their implementation. In fact, more they play their full and active role in the board's functions, more effective is their influence likely to be on issues bearing upon its corporate governance.

2.20 The Cadbury Committee Report specially referred to the role of outside directors in terms of board structure as well as the conduct of the board. The Code of Best Practices as recommended by the Committee, for instance, suggests that where the Chairman is also chief executive, it is essential to have a strong and independent element on the board, with a recognised senior member. (The KMB Report mandates half the
Board to be non-executive and independent, but makes no reference to the need for a senior or "lead" outside director in such cases). Since all directors have broadly equal legal responsibilities, as directors for the board's actions and decisions it is their independence of judgement which enables outside directors to play a particular role in boards deliberations and decisions. The Committee made the following recommendations in relation to role of non-executive directors in the corporate governance:

(i) Non-executive directors should bring an independent judgement to bear on issues of strategy, performance including key-appointments and standards of conduct.

(ii) The majority should be independent of management and free from any business, or other relationship which could materially interfere with the exercise of their independent judgement apart from their fees and shareholding.

(iii) Non-executive directors should be appointed for specified terms and reappointment should not be automatic.

(iv) Non-executive directors should be selected through a formal process and both this process and their appointment should be a matter for the board as a whole.

2.21 Most of these recommendations are now standard requirements in many countries. The KMB Report and many of the existing statutory provisions provide for several of these very valuable ingredients towards good corporate governance. Concepts such as independence of directors, non-executive directors, executive management, etc may, however, call for greater definitive clarity in statutory and regulatory documentation.

**Board Chair and Chief Executive Officer**

2.22 A topic of continuing debate in corporate governance literature and practices is the one relating to the positions of board chair and the company's chief executive officer.
Given the board's perceived role of overseeing the executive, there is a general consensus that the two positions should be separated. This was the recommendation of the Cadbury Committee in the United Kingdom but based on practical experience, its successor, the Hampel Committee concluded that companies may have the option of combining the positions but the reasons for doing so need to be disclosed in the annual report to the shareholders.

2.23 In India, the KMB Report recognises the differing roles of the two positions and expresses itself in favour of separating them but stops short of mandating this as a requirement. In this respect, it is closer to the Canadian guidelines on corporate governance which while recognising the need for independence and objectivity in the role of chair, do not accept the position that such a separation is the only option that would achieve the desired objective. What may be more appropriate at the present stage of corporate development in India is to follow the Hampel recommendation and have major listed companies explain in their annual reports reasons for not separating the two positions.

2.24 This issue has wider ramifications with respect to public sector undertakings and financial institutions like banks and insurance companies. It is virtually axiomatic in public sector corporations, insurance companies, banks, and financial institutions, to have a combined Chairman and Managing Director, or even when these positions are separated to have the chairman as a full time executive. Where there are external shareholders besides the government, and even otherwise, given the significant stakeholder interests are involved besides those of shareholders alone, the need for independent board oversight and surveillance in such cases is even more imperative than in others, and would call for separation of these positions into a non-executive board chair, and an executive managing director.

*Board Committees*
2.25 A major area of operational improvement in the efficient functioning of boards is the change in board processes, delegating specific responsibilities to smaller, specialised, and more manageable committees. This paves the way for not only better management of the full board's time and work but also, perhaps even more importantly, for much more in-depth scrutiny and attention to the key elements of successful implementation of board policies. It enables the board to have the wherewithal to discharge its onerous oversight responsibilities in governing the corporation for the benefit of all its shareholders.

2.26 Following the KMB Report, Listing Agreements now mandate appointment of an Audit Committee comprising a minimum of three members, all non-executive but the majority and the committee chair being independent as well. The proposed company law amendment also envisages an Audit Committee comprising three or more directors, at least two-thirds of them being non-executive. While both the documents list out in varying detail the duties and rights of the Audit Committee, its meeting frequencies, and so on, there is one important provision in the proposed legislation that is likely to be contentious. This deals with the clause that mandates that the recommendations of the Audit Committee on any matter relating to financial management including the audit report shall be binding on the board. Given the fact that the Audit Committee is a creature of the full board and derives its authority therefrom, it is difficult to accept a situation where the delegating-body becomes a captive of the delegated-body. A related question then is whether the other members of the board are absolved of any responsibility as to matters concerning the financial management of the company, a situation that clearly runs counter to the concept of collective responsibility of the board for the affairs of the company. The spirit of the provision appears to be laudable in that the full board should respect the judgement and expertise of the committee, and under normal circumstances should accept its findings and recommendations (as indeed of any of their committees). But clearly, the board should have the authority to override its subordinate body if in their wisdom the other directors believe it is expedient to do so, because in the ultimate analysis the entire body of directors will have to own responsibility. In the interests of transparency, what may be more appropriate is a provision that where any findings or
recommendations of the Audit Committee are overruled by the full board, the reasons for doing so may be set out in the annual report of the directors.

2.27 The KMB Report also refers to the appointment of a Compensation or Remuneration Committee but has not made it mandatory and consequently the Listing Agreements have not stipulated such a committee for the companies. Neither does the proposed amendment bill have any such provision. Going by international practices, such a committee will have a major contribution to make in the efficient implementation of board policies relating to recruitment, evaluation, and compensation of executive directors and other senior managerial personnel of the company. At least in the case of companies with a large board, it may be desirable to have such committees.

2.28 Many large corporations constitute special committees for reviewing and reporting upon issues such as governance policies, nominations for additional or replacement appointments to the board, performance measurement of the board collectively and directors individually, and so on. While there is no immediate need at this stage to formally mandate appointment of all such committees but rather leave the decision to the discretion of the companies themselves, there is probably a pressing justification to mandate a Governance & Nominations Committee, with three or more directors, all of them being independent. Such a committee could be assigned the responsibility of scanning potential candidates for board membership when the opportunity arises for additions or replacements. Being all independent, their discretion could be trusted to ensure that such additions or replacements are in the best interests of the company and further complement the skills and expertise of the board such that collectively they could contribute to better overall performance. The associated benefit of such nominations is that the chosen additions and replacements would be free from any sense of false loyalty or obligation and thus be better enabled to perform their role much more independently than would be the case if they were presumed to be the choice of the board chair or the chief executive.
2.29 This committee could also be required to review and self-evaluate periodically (say once every other year) the company's performance on matters relating to governance and recommend for endorsement by the full board any changes or improvements required. In smaller size boards, perhaps the nominations and self-evaluation functions could be left to full board itself.

**Directors**

2.30 More than ever, the role and responsibilities of company directors are under close scrutiny and surveillance by legislation, regulation, society in general and investor population in particular. There is a growing demand for accountability and performance.

2.31 A major consequence of these developments is that both the executive and non-executive directors have to assess their workload and competencies before deciding to take on additional directorship responsibilities. And on their part, companies will be obliged to compensate the directors adequately to be able to attract and retain them.

2.32 Corporate legislation currently prescribes a ceiling of twenty companies (fifteen in the proposed amendments) of which an individual could be a director. In practice, thanks to several permitted exclusions, this number can be exceeded significantly. The CII Code prescribed a ceiling of ten listed companies (meaning thereby a person could be a member of more companies so long they were not listed and the statutory ceiling of twenty (or fifteen) was not exceeded. Neither the KMB Report nor the amended Listing Agreements have any explicit provisions regarding total number of directorships.

2.33 The two categories of company directors, executive and non-executive, deserve separate consideration on this issue.

2.34 Executive Directors include company managing directors, functional directors, and other such persons, who hold a full-time appointment in their company. Very often, they have a service contract with the company like any other employee, and in this sense,
their contracts of service, not for service. Even when not so documented specifically, an employer-employee relationship in practice can easily be inferred, for example, through their membership of retirement funds meant for employee-managers of the company, or by the employee-perquisites valuation methods under tax laws being applied to their perquisites like housing or cars. Company law at present permits, under certain circumstances and with appropriate approvals, an individual to be a managing director of not more than two companies, but there is no bar to such managing and other whole time directors being on other boards as non-executive directors, within the statutory ceilings on total number of permitted directorships. It would be legitimate and reasonable for the shareholders of a listed company to expect their whole time directors including managing directors to devote all or substantially all of their time, to the affairs of the company. Clearly, any extra-curricular activities, such as being on boards and committees of industry associations, academic relationships, government or regulatory committees or councils, social responsibility initiatives, etc, that are aimed at benefiting their personal and corporate image thereby bringing value to their companies should be welcomed and encouraged. Beyond that, whether their time should be made available to other companies and activities can be contentious. Often, it is said that being on other company boards helps in broadening the exposure of the concerned individuals and providing useful inputs that may be valuable to the company. While this argument has considerable merit, it is debatable as to whether such insights could not be obtained from other business, professional and social associations without whole-time company directors having to undertake onerous additional responsibilities as non-executive directors on other company boards. It is also worth noting that many enlightened companies specifically preempt their executive directors (with limited exceptions) from serving on the boards of other companies as non-executive directors. It may be desirable to highlight this healthy convention and promote its adoption by legislation, regulation, or just persuasion.

2.35 **Non-executive Directors** include all members on company boards other than those employed whole time by the companies themselves. Here, the criteria for acceptance of board memberships should be their time commitments with their own
2.36 Experience elsewhere in the world is also indicative of a market preference towards a limited number of directorships. A recent study of directorships in the United States placed the average at between 2 and 3 directorships. The Vienot Committee report on corporate governance in France indicates three directorships as the preferred maximum. There is a case for gradually reducing the number in India consistent with the availability of a suitable pool of potential non-executive independent directors. A guideline number of 15 company directorships of which no more than ten could be on listed companies may be appropriate, with decisions in specific instances being left to the discretion of the companies and the directors concerned.

2.37 **Rights, Responsibilities, and Default Liability of Directors** in their role as directors are also matters of serious concern that need addressing. As has been mentioned earlier, the role and responsibility of the directors collectively as a Board is to supervise, control and direct. It is the executive's prerogative and duty to ensure managerially board-approved or prescribed policies are efficiently, effectively, and ethically implemented in pursuit of shareholder wealth maximisation goals. Any consequential liability of directors (executive and non-executive) should be limited to the appropriate discharge or otherwise of these responsibilities. Directors would have to be judged on whether they have acted in good faith, in the interests of the corporation and all its shareholders, have they prescribed appropriate systems and processes, ensured they were put in place and monitored from time to time that they were being followed and complied with (by regular compliance certification by management supplemented by validation checks by internal audit or other surveillance systems), and whether they had reacted, researched, and
responded to instances of repetitive systems breaches as any normal prudent businessman would have done in similar circumstances.

2.38 While such systemic and process indifference or negligence should be assigned to the directors, transactional failures in compliance should be the responsibility of the executive management, including the Managing Director and other appropriate wholetime directors in their capacity as executives and managers. They have the duty and also the executive authority to ensure compliance and any failure should squarely be laid at their doors. Such an approach would have a salutary impact on operating management to take compliance issues seriously and at the same time meet the ends of justice and equity as well.

2.39 These issues assume significance in the context of various enforcement agencies seeking to charge the directors in their capacity as directors with transactional compliance failures as well as deeming them as responsible for operational activities such as for example in case of "occupier" responsibilities under the Factories Act and so on. Clearly in such instances, it is executive management including executive directors in their capacity as managers who should be charged for violations and breaches.

2.40 **Nominee and Ex-Officio Directors** form a distinct sub-group of the non-executive directors category. Leaving aside the contentious issues relating to the system of institutional nominee directors, there are other practical difficulties associated with this practice. More often than not, nominees are senior full time employees of the nominating organisations and have little free time (unless being such nominee directors is itself their whole time job, or is suitably factored into their job time-scheduling) to devote to the affairs of the companies of which they are nominee directors. Equally, senior bureaucrats with enormously responsible jobs in government or other public institutions will have difficulty in attending to the affairs of the companies on whose boards they sit by virtue of their office. As a result, their contribution often suffers and is limited. While no legislative or regulatory provision is recommended in this regard, nominating organisations and potential incumbents would do well to weigh these additional demands
before nominating or accepting non-executive positions on company boards. Requirements of, and contributions by the nominating institutions or government agencies could be better actioned respectively by appropriate monitoring procedures and special invitations for specific sessions rather than inflicting on their executives onerous responsibilities associated with directorships.

2.41 Committee Memberships. The KMB Report and the Listing Agreements prescribe that no director shall be a member of more than ten committees or be the chair of more than five committees across all companies where he or she is a director. This is a welcome provision in that it recognises that committee work involves additional time commitment. But all committees, like all companies, are not the same in terms of demands. It is generally accepted that while all board committees are important, Audit Committees possibly are the first among equals in terms of frequency of their meetings or comprehensiveness of their scope. Directors may have to weigh these demands before accepting memberships of board committees. Also, it may be appropriate to exclude from this computation any adhoc or routine committees such as share transfer committee, which while being important may not be as demanding as for example the Audit Committee.

2.42 It may therefore be appropriate to mandate an upper limit of membership of no more than ten committees of which no more than four shall be of Audit Committees, chairmanship of no more than five committees of which no more than two shall be of audit committees. For purposes of these ceilings, only three committees shall be reckoned, viz, audit, remuneration, and nomination committees. In the case of managing directors and other executive directors in full time employment of listed companies, it may be appropriate to limit managing directorship (including functional executive directorships) to one only, additional non-executive directorships to no more than three, and board committee memberships to no more than two (including not more than one of an audit committee), and chairmanship of such committees to just one, which shall exclude being an audit committee chair. As in the case of other directors, in this category also only audit, remuneration and nominations committees shall be reckoned. In all cases,
limitations on number of boards, committees, chairs etc will not apply to subsidiary company positions, within the overall statutory ceilings.

2.43 With regard to remuneration or compensation committees, the French Vienot Committee had introduced a salutary provision which deserves to be emulated. The chairmanship and membership of the remuneration committee shall not be open to a director who is himself or herself an executive director in another company whose compensation committee is chaired by the executive director of the first company. This is intended to preempt mutual back-scratching that may well happen if each such executive director has an influencing or deciding role on the compensation of the other such executive director.

2.44 Given the range of variations in company size, complexity, geographical and cross border spread, and other such factors, any broad brush ceilings on membership of either boards or their committees are likely to be arbitrary. Perhaps, the concerned individual is the best judge of what is right in specific cases. Any legislative or regulatory provisions in this regard should be treated just as upper limits are not to be transgressed.

**Summary of Recommended Limits on Board/Committee Memberships**

(Subject to Statutory Ceilings & Board Concurrence)

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<th>If NOT a Managing or Wholetime Director in a Listed Company</th>
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<td>Of Which, Audit Committee Membership can</td>
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39
Directors' remuneration, particularly of managing and whole-time directors, has always been an emotive issue in pre-liberalisation India, clouded as it was under the complementary compulsions of public policy, socialist goals, civil servants pay, and so on. Fortunately, these inhibitions have now largely been done away with, except for some overall company profit-dependent ceilings. Non-executive directors' compensation packages in recent times especially in IT and other 'new economy industries' have been worked out to attract good talent on to the boards; appropriate remuneration also facilitates independence besides formally legitimising demands for greater accountability and improved performance from such directors. There is however a case for retaining some measure of societal or legislative control on total managerial remuneration. The worst fears of goal-non-congruence between shareowners' interests on the one hand, and on the other, controlling-dominant shareholders-executives were more than confirmed in the closing decades of the last century with outrageous pay packets for the executives in several developed countries as for example in the United States. However, the kind of compartmentalised ceilings that exist now in company law need to be replaced with just one overall ceiling percentage, leaving actual distribution to company boards and their remuneration committees.

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<td>Committee Chairs in:</td>
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<td>Audit Committee Chairs in:</td>
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<td>Listed Companies</td>
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Notes: All numbers are desirable upper limits; memberships in Boards, Committees, Chairs of Non-listed companies left to individual discretion subject to statutory ceilings; In column 2, the first number represents the company where the person is a managing or whole-time director and the second, other companies.

2.45
2.46 All directors, executive and non-executive, should be adequately compensated for their time and effort, even in cases of absence or inadequacy of profits. Company law at present provides for minimum remuneration in such cases, to managing and whole-time directors within prescribed monetary limits. There is no reason why similar considerations should not apply to non-executive directors as well, as they contribute their own time and expertise in guiding the companies forward. It is important to recognise that professional independence of non-executive directors and the legitimacy of demands on their accountability need to be matched by the reward systems in place in companies.

2.47 It may be worthwhile to provide for two broad components of remuneration to all directors, one based on profits and the other based on their time, effort and contribution. Emerging trends indicate that such remuneration usually takes the form of a fee for attending board and committee meetings, a commission dependent upon the profits of the company, and stock options. Within the overall statutory ceilings and regulatory provisions, companies should be free to decide these components and the methods and periodicity of payments, having regard to industry practices and the need to attract the right talent to serve on their boards. Practices such as a regular monthly retainer, performance-based profit bonuses, incremental fees for board and committee chairs that involve additional time commitments, and even for membership of time-intensive committees such as audit committees, all deserve to be encouraged in the interests of developing a healthy, independent, and contributing pool of non-executive directors.

Board Processes for the IT Age

2.48 Board and Committee meetings, as presently contemplated in legislation, require the physical presence of the directors at the meeting site. Increasingly, company boards are becoming geographically spread out and given the demands on time for travel and meetings besides one's own personal and professional commitments, such physical attendance is proving to be difficult and expensive. The situation is only likely to be
further aggravated with the increasing demand for independent non-executive directors and the moves to reduce the number of board and committee memberships.

2.49 Recent advances in information and communication technologies make it possible for people to "meet" and participate in discussions through audio and video conferencing. It should therefore be possible for directors located in geographically distant places to carry on a meaningful discussion on issues, without necessarily having to travel to the meeting location. Business conferences and discussions already take place on this basis and in tune with the times, it is appropriate that legislation recognises this reality as indeed an opportunity to secure wider and more frequent participation by the directors. That the IT legislation validates many of these techniques including digital signatures is a step in the right direction. Of course, there are possibilities of abuse, intended or otherwise, of the system, and these will have to be addressed by suitable safeguards and security measures.

2.50 Subject to authentication of the audio or video tapes and subsequent sign-off by the directors concerned, it is recommended that all Listed companies be encouraged to use these technologies, and corporate law be appropriately amended to include such participation for purposes of board and committee meeting quorum requirements. Once this provision is made, legislation could insist that the majority of directors participating, physically or electronically, should be independent to qualify as a quorum for legitimising the business of the meetings. A text confirmation by fax or mail of the minutes of the meeting may also be required from the "electronically participating" members to ensure that their views and decisions have been correctly reflected in the minutes to be confirmed at the following meeting.

Operational Management and Control

2.51 While a competent and independent board of directors is a prerequisite to ensure created wealth is applied for the benefit of all shareholders, the board and the executive
management of the company have to address the all important task, in the first place, of creating and protecting such wealth and wealth-creating assets and resources. Policy-making structures and managerial and operational processes that help achieve these objectives are indeed key constituents of good corporate governance.

Management

2.52 A company is managed by its chief executive and his or her team of supporting officers and other executives, and not by its board of directors on a day-to-day basis. In this view of the matter, references to board-managed companies are indeed an incongruity that needs to be avoided. Where there is a managing director, he or she performs a dual role, one of being a director on the board and the other of being the executive operating under the supervision of the board. Function wholetime executives who are also on the company’s board similarly perform two distinct roles. It is another matter that more often than not, it is extremely difficult for such wholetime directors to be able not to carry their executive hierarchical subordinate relationships with the managing director into the board room.

2.53 The executive’s role is to formulate strategy for consideration, comment and concurrence by the board, and thereafter for its implementation within the legal and ethical framework within which the company operates. Shareholder wealth maximisation with due regard to other stakeholder interests and societal responsibilities is the primary concern of management which for this purpose should equip itself with the skills and competencies that would enable it to achieve its goals. An illustrative list of management functions has been set out in the KMB Report that can well serve as a guide to management responsibilities in a company.

Control

2.54 As part of its stewardship responsibilities, the board has to satisfy itself that the control mechanisms within the organisation are well in place and that they are in fact
operative. The Cadbury recommendation was that the board should report to the shareholders on the effectiveness of the internal control system, with the auditors reporting thereon. On review, the Hampel Committee in 1998 decided to omit the word effective from this requirement in the light of difficulties in interpreting the term, and on the ground that the directors while reviewing internal controls will be obliged to assess their effectiveness. Also, the committee felt that there was little to be gained by asking the auditors to publicly comment upon the directors' report on internal controls and instead, it would be more functional if they were to report privately to the directors.

2.55 More importantly, Hampel extended the coverage to all aspects of control, not just financial controls. This would now include in its scope business risk assessment and response, financial management, compliance with laws and regulation, and the safeguarding of assets including minimising the risk of fraud.

2.56 The Canadian position expounded in 1994 is very similar and in many respects the guidelines articulate the scope of the requirements in greater detail. Among the examples cited is the one relating to reviewing and approving financial information where "the board will want to ensure the corporation has an audit system which can inform the board on the integrity of the data and the compliance of the financial information with appropriate accounting principles". The emphasis throughout is on board responsibility, not so much for validation of individual transactions or instances, but more importantly to ensure that appropriate systems for the purpose are in place and they are in fact being complied with and acted upon.

2.57 The Indian position is well articulated in the KMB report. The Board is responsible for controlling the company and its management by "laying down the code of conduct, overseeing the process of disclosure and communications, ensuring that appropriate systems for financial control and reporting and monitoring risk are in place, evaluating the performance of management, chief executive, executive directors, and providing checks and balances to reduce potential conflict between the specific interests of management and the wider interests of the company and shareholders including misuse
of corporate assets and abuse in related party transactions." The description is indeed quite comprehensive even if somewhat detailed but at the threshold of governance reforms, the committee probably felt the need to enumerate the components of board responsibility in the interests of clarity.

2.58 Mention should also be made here of the significant efforts that have been made elsewhere in the developed world to redefine and articulate the concept of control. The COSO framework following from the Treadway Report in the United States, built upon further by the CoCo, in Canada and the Turnbull prescriptions in the United Kingdom are all measures aimed at better defining and describing control concepts and assisting corporate directors and managers in better addressing control issues. The COSO framework is built upon the required constituents of an appropriate control system identified as the control environment in the organisation, systems for risk assessment that would highlight potential exposure areas, and control activities that the organisation must initiate to meet those risks. Running through these components of the control mechanism would be comprehensive and timely system of information and communication right across the corporation to enable informed actions and corrections to be initiated. Of course, no system of control is complete without a regular monitoring component. The time is opportune to request the Institute of Chartered Accountants of India, the Institute of Cost & Works Accountants of India, the Institute of Company Secretaries of India together with other industry and business bodies to research this area in the Indian context and come out with guidance notes for the benefit of corporate directors, managers, auditors and regulators.

2.59 An important element of any control system is the internal audit and assurance function that could value-add by ensuring that laid down policies are faithfully adhered to in operation and any deviant behaviour is flagged as soon as practicable, if not preempted through appropriate financial and control procedures. The audit committee and the board need to be assured from time to time that necessary and appropriate systems are in place within the company and that they are being followed. Future internal auditors will need to
develop a corporate governance orientation to be able to successful perform their assigned role in corporate management and control.

2.60 Similar comments apply to the legal compliance framework of the corporation. The company secretary, till now charged with the responsibility of ensuring procedural formalities will, in future, have a significantly demanding role to play in ensuring adherence to best governance practices in the board room, committee work, and in day-to-day administration on a transactional basis so that the desired transparency and proprietary interests of the company are at all times safeguarded for the benefit of the shareholders and other stakeholders.

2.61 The KMB Report clearly distinguishes between the oversight role of the board and the implementation role of the executive in matters of control as indeed in other matters as well. In the discharge of this oversight responsibility, the board will have to draw upon expert, professional, and independent support from the statutory auditors. Independence of the company's auditors thus assumes great significance. Criteria of independence of auditors have long been debated. Economic independence is almost invariably the fundamental determinant of professional and personal independence. It is in this context that in the United States measures are under way to separate the audit activity from other kinds of services such as consulting, and the result is that several large firms internationally have moved towards such separation. There is an Independence Standards Board constituted by the Securities and Exchange Commission with equal representation from the professional audit and business segments that is in the process of bringing greater clarity to the whole issue of auditor independence. There is a case for a similar body, perhaps advisory in the initial stages but more regulatory later on, to be constituted by the SEBI, the Institute of Chartered Accountants of India and the Institute of Company Secretaries of India, Institute of Costs and Works Accountants of India. Of course, several self regulatory provisions already exist, and company law also prescribes disqualification in audit appointments, but in a dynamically changing situation, and with the prospect of increased globalisation of Indian business including possibly accountancy
and consultancy practices from April 2001 following WTO commitments, there may be a case for a closer look at these issues.

2.62 In the case of internal audit and assurance function, the board must ensure that the positions are staffed with competent and independent professionals, that they are of sufficient hierarchical seniority in the organisation, and that their remuneration and growth prospects are carefully planned and monitored. In particular, removal of internal audit chiefs (or external firms doing the service) for whatever reason must be carefully examined to ensure that an inconvenient internal auditor is not eased out of his position to the detriment of the company and its shareholders.

**Reporting & Disclosure**

2.63 Company law in India requires a company's board to provide an annual report to its shareholders. The minimum contents of the report and matters requiring disclosure have been prescribed, as have been the formats in which the company's financials are to be prepared, audited and submitted to the shareholders. The auditors' report is a significantly detailed document and is required to be actually read out at the annual general meetings of shareholders. Considering the less than satisfactory attendance and even worse levels of participation by shareholders at such meetings, there is a case for removing this requirement altogether.

2.64 Shareholders are required to decide on a number of matters and it is important that the company provides its shareholders adequate information to enable them to exercise their votes. Company law again provides for explanatory statements to be provided to shareholders on certain key matters that require approval by a special resolution.

2.65 The KMB Report applicable to all listed companies has made several mandatory requirements with regard to periodical provision of financial and other information to shareholders, using electronic media wherever possible. It has also recommended reporting measures such as consolidation of subsidiary company accounts, segment
reporting, disclosure of related party transactions, and deferred taxation, and has suggested that the Institute of Chartered Accountants of India be requested to issue appropriate guidelines and standards for implementing these. Some of these may also require legislative intervention. SEBI as the principal capital markets regulator has also introduced several innovative reporting requirements in respect of public offers, quarterly results, half yearly limited review audits of results, and so on. There is also a requirement in listing agreements that compliance with corporate governance requirements must be reported upon by the company's auditors. There is a case for extending this certification such that either the company's auditors or a firm of practising company secretaries should report on such compliance. These are all steps in the right direction. A few other issues that remain to be addressed, some relating to small shareholders and others affecting all shareholders, are now discussed.

Annual Reports & Other Corporate Returns

2.66 It is axiomatic that any communication should address the needs and requirements of the intended audience or recipients. The successful communication is one that offers information (as opposed to just data) that is right in terms of its timing, content, focus and presentation. Annual audited company financials and directors' reports are a key instrument for interaction not only with shareholders but also with investors and other interested stakeholders. A large number of corporations worldwide use these documents to great effect and advantage in informing, enlightening, marketing and projecting their organisations to interested recipients, far beyond the call of statutory duty and obligation. Barring a few notable voluntary exceptions, India unfortunately lags significantly behind the developed world in this key area of invaluable potential.

2.67 The greatest danger of trying to cater to the differing needs of diverse recipients of this key corporate document is that it satisfies none of them fully and ends up with a medley of data so enormous and comprehensive that it is difficult and time consuming to literally separate the relevant from the irrelevant from the varying requirements and perspectives of its intended audience. And in no small measure is this due to the outdated
and out-of-tune requirements of the Companies Act in general and its Schedule VI in particular. There is a pressing need to revisit financial disclosure requirements expected of Indian companies in the light of emerging world trends in reporting and specifically in response to what the recipient population needs and how the companies can be encouraged to provide meaningful information through this very important medium.

2.68 Numerous examples could be cited of the inappropriate requirements relating to disclosure in financials and otherwise in annual reports. Subsidiary company financials are a case in point. Larger the number of subsidiaries, more the number of such subsidiary company financials to be included in the parent company’s annual report, making the document unwieldy and cumbersome. Would it not be more functional to seek consolidation of subsidiary financials with the parent company with due provision for minority interests, and a summary statement of parent interests in different subsidiaries? Most developed country reports follow this convention and neither the parent company shareholders nor any other stakeholders seem to have been adversely affected by this practice so far. Of course, there are issues such as the income tax legislation not recognising the “group” as a taxable entity on its consolidated results, but corporate law could perhaps take a lead in bringing about this reporting reform and persuade other wings of government to follow suit. Similarly, inconsequential details of sales and purchases of materials and services and so on required to be disclosed as part of annual financials have not perceptibly improved corporate governance practices or helped shareholder wealth maximisation objectives, and yet they continue to be required much to the satisfaction of the company’s competition and a range of database-providers. Very much similar is the Section 217 statement of listings of employee remuneration which are reportedly the key interest section in the annual report equally to placement consultants, jealous wives and potential parents-in-law. It may be more meaningful to require disclosure of earnings-spreads in bands, numbers or percentages of numbers and value as far as the real; investor is concerned. The message is really in the aggregates rather than in the detail.
2.69 The Task Force is strongly of the opinion that an initiative be mounted to research and design a 21st century model of corporate financial and governance disclosure format, in collaboration with professional bodies, industry associations, investor groups, regulatory authorities and the government itself. It is suggested that a basic minimum level of disclosure be prescribed for the shareholder and investing public, with special requirements of other players being met by specific filings and returns. The intention is not to dilute corporate disclosure but to direct it to meet generalised and specialised requirements appropriately.

2.70 If Indian companies are to be competitive on a global basis, it must be ensured that their reporting requirements also match global standards. The present reporting requirements for Indian corporates are archaic and utterly out of tune with the reality of the information needs of the shareholders and other stakeholders. Corrective initiatives are called for on a priority basis. This is not to say that disclosure requirements need to be diluted. Far from that. The Task Force is convinced that much more meaningful disclosure of corporate behaviour and performance is called for, but that it should be met by specific requirements of the statutory and regulatory authorities. The Task Force recommends that it would be desirable to constitute a separate Committee to look into the aspect of making Annual Reports more informative and user friendly and also suggest a model corporate Annual Report. Already, companies are under obligation to file several specialised returns and reports to various statutory authorities, regulators, and others. Besides, with growing sophistication in capital markets, companies on their own provide detailed and tailor made information to analysts and other market advisers. SEBI is already working on an electronic database proposal similar to the EDGAR in the United States, that would call for detailed information from listed corporations and make them transparently available on their web site for accessing by interested parties. DCA receives enormous data from companies under the provisions of the Companies Act, Rules and Regulations; these could be further enlarged if required, and this store house of data could be made available to the public electronically, since most of the information is anyway open for public inspection at the offices of Registrars of Companies.
2.71 The prescribed auditor’s report is far too detailed and cumbersome, and certainly calls for a major revision. A simpler and more direct report, highlighting deviations from acceptable or expected norms, will lead to better comprehension and appreciation by not only shareholders but also by a vast population of other stakeholders including employees. The intention is not to suggest any diminution in audit rigour but to enhance its reader-value. This improvement requires legislative and professional support. Similarly the verbose MAOCARO requirements should either be eliminated wholly or retained only on the basis of negative reporting, with the advantage that any critical violations would receive sharp highlighting as opposed to the present system where they could virtually be lost.

**Integrity of Financial Statements**

2.72 Shareholders need to be assured of the integrity of financial and other statements made in company reports. They need to be assured that well accepted accounting standards and conventions have been followed in the preparation of financial statements. The proposed National Advisory Committee on Accounting Standards is a welcome step in this direction and needs to be fully supported.

2.73 The standards-setting process needs to be reviewed and strengthened. Following the KMB exhortation to expedite issue of accounting standards on certain key topics such as consolidation of subsidiary company accounts, segment reporting of results, and so on, the Institute of Chartered Accountants of India have accelerated the issue of exposure drafts and related processes but more may have to be done on an ongoing basis. There is a clear case for setting up a fully equipped secretariat with competent full time research, administrative and support infrastructure, either within the Chartered Accountants Institute framework, or under the proposed National Advisory Committee on Accounting Standards.
2.74 With several Indian companies accessing global capital markets and with increasing participation of global players in the Indian capital markets, there is rightly a move to present company accounts under international standards and generally accepted practices. Barring a few notable exceptions, however, Indian companies continue to follow different accounting practices in respect of their "Indian" accounts and the "GAAP accounts". Except where specifically prevented by Indian law or professional pronouncements, there would appear to be no justification for following this practice. Shareholders and investors in India would like to see accounts presented to them on compatible conventions, with explanatory notes for variations mandated by Indian law or custom.

Shareholder Democracy & Protection of Minority Interests

2.75 Corporations are owned in a legal sense by shareholders who subscribe to their equity capital on the basis of a public offer or a private placement, in either case relying upon the stated objectives of the company in the offer document. They exercise their rights in general meetings of shareholders of the company. Usually (and in India, actually) their voting rights are proportional to their shareholding. Current company law requirements mandate a 75% majority in certain matters and a simple majority in other cases, of those present and voting (personally or through duly recorded proxies) at the meeting. A show of hands is usually enough for the chair to determine if a resolution has the required majority. There is of course a provision for poll in case of any doubts or when demanded by eligible shareholders.

2.76 Because of their initial and ongoing reliance on information provided by the company and those responsible for its governance, shareholders seek and are entitled to some protection from being deceived or unfairly treated by those in operational control. Reporting and disclosure requirements and best practices are developed to meet this need. More importance is also attached to protecting the interests of minority shareholders on the basis that by themselves individually they may not have the resources to protect themselves. But what is important to note in this context is that no protection is justified.
or to be expected by any shareholder including the minority shareholder in respect of the equity risk that he or she takes when investing in risky instruments like company shares. SEBI requirements for highlighting risk factors in equity offers is an example of how potential investors should be made aware of the nature and extent of the risks involved in investing. Protection of shareholder interests should therefore be applicable to matters relating to transparency in accounting and reporting, majority oppression, biased management, non-conforming to obligatory requirements, and so on, but certainly not to issues arising from normal business risk that equity investments are subject to.

Non-Institutional Minority Shareholders

2.77 Internationally, ownership trends seem to portend a declining population of non-institutional minority shareholders (NIMS) in corporations. This is accompanied by a corresponding increase in the proportion of Institutional shareholdings. For example, in the United States, institutional investments in the top 1000 companies rose from 46.6% in 1987 to 57.2% in 1995. The trend in the United Kingdom is similar: from 30.3% in 1963 to 61.8% in 1993. The situation in many emerging markets is no different. Among the several contributing causes to this trend, the dominant appears to be a widely held perception that NIMS end up the worst, since they have neither the benefits associated with controlling shareholders nor the expertise or clout of large institutional investors.

2.78 The Indian situation seems to be slowly heading in the same direction. A 1989 IDBI survey of ownership patterns of 575 companies assisted by all-India financial institutions indicated individual shareholders held some 35.80% of their equity as of June 1986. Out of these, comparative data as of June 1982 available in case of 150 companies indicated a fall in individual shareholding from 43.93% in 1982 to 42.32% in 1986. In 1996, based on a much larger sample of 1613 private sector companies, individuals held 41.00% of their equity.

2.79 This trend may gain further momentum in the years ahead, with a growing number of mutual funds entering the fray and also performing better than in the past;
opening up of insurance and pension business is also likely to have its impact with many of them channelising their investments into capital markets.

Role of the Corporations

2.80  Given the desirability of developing a healthy mix of share ownership structures as an integral constituent of the capital markets reform and upgradation, there is a strong case for sending appropriate signals to minority shareholders that their interests will be duly taken care of.

2.81  There is also another compelling reason for the controlling groups to encourage a stable NIMS population in their organisations. Much of the governance debate and guidelines in the developed world flows from the Berle & Means hypothesis concerning separation of control from ownership. More recent studies, particularly by Rafael La Porta and others, question the universality of the Berle & Means findings with evidence to the contrary from several other countries. A major conclusion is that, particularly in countries with poor shareholder protection, even the largest of firms tend to have controlling shareholders, sometimes the State, but more often a founding family or its descendants. Concentration of minority or external share ownership in the hands of powerful institutional investors may not be a welcome situation for the controlling owners to look forward to in such circumstances. One mitigating alternative to this dilemma is a numerically strong and widely dispersed NIMS population. Given the present stage of development of a market for corporate control in many emerging market economies, and also the fact that institutional shareholder activism may not always be a blessing until ground rules are well laid down and accepted, it will be in the mutual interest of company managements and NIMS to co-exist in an atmosphere of trust and understanding. There is thus every reason for corporate India to go that extra mile to retain and to enlarge the size of the NIMS component in the structure of share ownership in companies.
2.82 There is a view that in a competitive market place, each player should take care of his or her own interests, and should not expect any special handholding or other safety props. Clearly, given the disparate strengths and skills of various players in the field, this is far too ideal a situation to deserve any detailed debate. Analogously, on this basis, there should be no protection whatsoever for business and industry from domestic or international competition, there should be no cross-subsidisation between and among products and people, and so on. But every country and every society does call for and provide some form of cover to protect its own interests. The legitimacy of minority shareholder protection stems from this basic premise.

*Role of Institutional Investors including Mutual Funds*

2.83 Internationally, there is an ongoing obsession with the role, power, responsibility, and accountability of institutional investors including mutual funds. Large pension funds such as the CalPERS in the United States wield enormous clout in pushing corporations to initiate governance improvements that would lead to improved financial performance. In India, large investors like the Unit Trust of India have in recent times moved in the direction of monitoring corporate performance of large companies.

2.84 What can institutional investors do in this direction? Their primary objective is to maximise wealth for their own constituencies and this responsibility will provide a major purpose in enhancing and protecting their own rights as shareholders in corporations. Their expertise and resources will provide the means for achieving these objectives. Their ability to encourage and promote contestability will by itself have a salutary impact on incumbent managements, leading to better performance.

2.85 Institutional investors, however, should be alive to the negative impact of their actions may inadvertently have that may lead to adverse results in terms of shareholder wealth maximisation. They should eschew any trigger-happy attitudes of dislocating incumbent managements that may divert them from their long-term focus on business.
2.86 Institutional investors should also lead by example in terms of transparency and
good governance in their own operations, and decisions on investee company proposals.
Widely disseminating their position and justifications on company proposals (say by
posting this on own or those of their investee companies web sites) will enhance their
image as objective and rational shareholders working for the benefit of all investors.
However, the fact that nomination of directors on Boards of assisted companies gives the
institutions the ability to obtain insiders information and therefore the ability to misuse
such information for the benefit of the institutions which they represent needs careful
consideration.

Role of Watchdog Groups

2.87 In the absence of, or in addition to, the efforts of companies themselves and/or
institutional investors in this regard, specialist watchdog groups will step in to protect the
interests of minority shareholders. Corporate Monitoring Firms are a manifestation of this
potential, where, as independent experts, such firms seek to evaluate company actions
(and inactions) on behalf of the minority shareholders. The free-rider problems are
sought to be mitigated in this format through the investee companies being asked to bear
the costs of such surveillance, thus spreading them equitably across all shareholders.

2.88 The efficacy of such a monitoring system, particularly in developing countries
could of course be questioned. Experience in some countries with shareholders
associations (with somewhat similar objectives of protecting minority shareholder
interests) has not been particularly happy, with vested interests developing between the
association officials and companies. Corporate governance initiatives around the world
are moving towards strengthening independent directors, independent auditors,
independent regulators, and so on to protect the interests of all shareholders, including
NIMS. At least in the near future Independent watchdogs may not be appropriate.

Some Issues for Consideration
2.89 Following are some issues that concern minority shareholders not currently addressed adequately by legislation or by self-regulation that need to be pursued in the interests of improved corporate governance.

Concept of Interested Shareholders for Certain Purposes

2.90 Joint stock format of organisation is based on one-share-one-vote (though instances of disproportionate voting rights are prevalent in some countries) and decisions on key matters requiring shareholders’ approval are usually decided on the basis of a simple (or specified) majority of votes, of shareholders present at such meetings. It is also well established that shareholders as owners of property in the form of shares are well within their rights to seek and obtain what is in their interest. While these principles are valid and fully justified in cases where decisions sought or taken impact on all shareholders equally, it may not be so in other cases where a decision impacts favourably or adversely upon a section of the shareholder population to the exclusion of other shareholders. A brute majority decision in such instances may be inconsistent with the canons of equity and justice as far as the adversely affected minority are concerned.

2.91 One possible way to overcome this difficulty is for the interested shareholders to abstain from voting on such resolutions. In a sense this is analogous but of course not the same as the already accepted principle of interested directors (in the discharge of their fiduciary responsibilities) not voting on board resolutions bearing upon their own interest. In this event, the affected shareholders can weigh the pros and cons of the proposal (for which purpose, explanatory statements may provide comprehensive material particularly highlighting how all the shareholders including the minority shareholders will benefit from the action) and vote appropriately. Dissenting voters could be given the option of selling their holdings either to the company (under a buy-back scheme) for extinguishment, or to the beneficiary shareholder group at a fair market price.

2.92 The concept of abridging individual shareholder rights in the interests of a wider public or population of shareholders is not entirely new. Even the principle that certain
resolutions require 75% majority instead of just a simple majority recognises the need to protect the interests of a larger proportion of the shareholder population. Instances of interested shareholders not being permitted to vote on certain resolutions such as buy-back of securities in off-market transactions or in excess of certain prescribed limits in a twelve-month-period can be found in company legislation in the United Kingdom and Australia.

2.93 Companies Act in India has a series of provisions that apply in cases of oppression and mismanagement. Given the growing demands for transparency and fair play in corporate governance, together with the increasing distancing of share ownership at large from dominant or executive control of corporate management, the Task Force considers it appropriate to introduce this concept in certain specific instances and types of matters where inequitable decisions may be reached by the exercise of majority power.

2.94 To prevent abuse of these provisions, their applicability could be limited to instances where the interested category comprises of 76% or less of the total equity of the company. Also, in order that this does not lead to situations of tyranny of a vested interest minority over the beneficial interests of the company and its larger population of shareholders, an appropriate stalemate resolution mechanism may be set in place where the company and its aggrieved shareholders may seek redressal from unjust and malafide abuse of this protective facility intended for the genuine minority shareholder interests.

2.95 Some of the instances that may warrant application of the interested shareholder concept are enumerated below.

Selective Preferential Issues

2.96 These include instances such as when an allotment of equity shares is made to a section of the shareholder population such as an overseas MNC at an advantageous price. (SEBI requirements in this regard have brought about a measure of control in recent times, at least on pricing of such issues). Quite frequently, such allotments are made to
raise the controlling or dominant shareholders’ equity stake in the company, either to convert it into a subsidiary or to enhance the status to a level such as 75% where the other shareholders cannot block any actions of the dominant shareholders through the special resolution route provided for by company legislation. Usual reasons offered for such allotments are that the company will benefit from easier flow of updated technology, greater commitment or involvement by the overseas shareholders, etc.

Setting up Competing Ventures

2.97 Given the continuing liberalisation of the Indian economy, there are more opportunities becoming available to overseas investors to set up fully owned subsidiaries in the country. While this is a welcome development from the perspective of intending foreign direct investors, this does create inequities in cases where they already have a less-than-100% equity interest in a subsisting listed company. When such 100% FDIs are approved, there is a demonstrable erosion in the value of equity in the subsisting company to the detriment of the retail investors. While such erosion would also impair the wealth of the dominant or controlling holders, they have the countervailing advantage of improving their overall wealth from Indian investments through the 100% subsidiary to which more profitable brands, technology, etc could be routed.

2.98 In such competing companies being set up by the MNC (and for that matter even by domestic dominant groups) a satisfactory solution could be to convert the subsisting company into a 100% subsidiary, the MNC or the dominant shareholders being asked to acquire the residual shareholdings from others at a fair price determined in line with SEBI guidelines or other independent valuation. Alternatively, the newly formed 100% subsidiaries may be asked to acquire the subsisting listed company at a fair valuation based on pre-announcement market price data so that minority investors could at least be protected from value erosions due to the migration of the profitable business, even if not assuring them a share of the future prosperity.
2.101 The Task Force is conscious of these proposals running the risk of criticism that they would be inimical to the general policy of welcoming foreign direct investment in an environment of economic liberalisation. It must however be appreciated that the kind of level and transparent business relationships that corporations seek to develop with their investors does come at a cost, whether it is in their home country or in the host country. And it is not the intention of these proposals to deny freedom of action to such

Buy-back of Shares

2.100 While the concept of shares buy-back by companies is wholly welcome, there may be a need to ensure that corporate funds are not used to the detriment of minority or non-controlling shareholders especially when the proposals involve buy back from the controlling shareholders or their associates, or when the result of the buy-back would be to entrench managements that have any way not acquitted themselves creditably in terms of good governance. SEBI guidelines do provide several checks in regard to buy-back proposals, but it may be useful to apply the interested shareholder principle in resolutions approving such buy-back schemes.

Impact on Foreign Direct Investment

2.101 The Task Force is conscious of these proposals running the risk of criticism that they would be inimical to the general policy of welcoming foreign direct investment in an environment of economic liberalisation. It must however be appreciated that the kind of level and transparent business relationships that corporations seek to develop with their investors does come at a cost, whether it is in their home country or in the host country. And it is not the intention of these proposals to deny freedom of action to such

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companies, it is only that they have to factor in the additional cost of protecting the smaller investors' interests in managing the transition.

**Directorships in Competing Ventures**

2.102 On the question of involvement of directors in competing ventures, cases of executive and non-executive directors need to be distinguished. Executive Directors should ordinarily be precluded from taking up directorships in competing companies unless specifically supported by the board of their companies, with the concerned executive director abstaining from the discussion and decision.

2.103 Non-executive directors, however, should be able to serve on boards of companies in materially the same lines of business, so long as they are professionally comfortable and are able to respect the confidences of all the companies concerned. They should however disclose their association to the board prior to their accepting such appointments, and also follow a policy of not participating in or voting on any matters where there can be a potentially perceived conflict of interest.

2.104 It may be a worthwhile convention for companies to disclose in their annual reports to shareholders the names of the directors and the companies that may be competing in material lines of their business.

**Disclosure of Material Collateral Agreements and Intentions**

2.105 If the intention of the principal or dominant shareholders in a company is to acquire 100% ownership when permitted, it stands to reason that such an objective is highlighted in the offer document issued to the public when inviting equity investment. The company's standing and reputation for transparency and fairness in communication would greatly benefit by such a statement followed by a description of how the buy-back would be accomplished subject to regulatory provisions and guidelines. Minority
2.106 Similar is the case for disclosure of material details of any shareholders’ agreements or other understanding between the joint venture partners in a listed company. In the current stage of development in the country where several listed companies are controlled/managed by dominant groups with or without MNC association, it is important that companies disclose if, to their knowledge, any shareholder agreements exist between and among any of its dominant/controlling shareholders and the principal contents of their agreements. Such a disclosure provision is not unusual in countries where several listed corporations are controlled by domestic or foreign dominant shareholders; a case in point is Belgium.

Non-Compete Covenants

2.107 Competition is the foundation of a liberalised economy. But should listed companies with the same controlling or dominant shareholders (and obviously with different sets of retail investors) compete with each other? A somewhat similar instance of such a competing situation is offered by the (earlier discussed) 100% subsidiary route adopted by some of the MNCs with controlling interests in a subsisting company (even though there will be no retail investors in the fully owned subsidiary).

2.108 Company legislation does provide for disclosure of material transactions between companies in which directors are interested, or between companies under the same management. There is, however, no bar on such companies competing with each other.

2.109 Highest standards of corporate governance should, conceivably, seek an assurance from the controlling or dominant shareholders that so long as they retain that status, they shall not acquire control or dominance of another business that in material respects competes with the company. A report from the Practising Company Secretary regarding continuing compliance in each year’s annual report to the shareholders and other statutory
or regulatory returns and documents, would go a long way in building shareholder credibility on the professionalism and transparency of the incumbent management.

*Related Party Transactions*

2.110 Another source of possible wealth transfer from one company to another is through related company transactions not in line with arms-length principles. Inter-corporate investments and loans even between holding and not-fully-owned subsidiaries at non-commercial terms are a case in point.

2.111 Compliance with this requirement may prove particularly cumbersome and suspect in the case of companies which are subject to transfer-pricing of their input or output materials, technology, and services. The situation is compounded when the contracting party is an MNC with a direct or indirect equity control or management control in the company. Perhaps, an annual affirmation in shareholder reports and other communications, that material transactions involving transfer pricing from the controlling or dominant shareholders, either directly or through control or dominance of the business, have been on an arms-length basis, and in line with their international policies for such transfers, may be a good beginning.

*Compliance with Listing Covenants*

2.112 Of late, many companies appear to be heading for de-listing due to non-payment of dues etc. Listing (at least in theory) being a fundamental ingredient of liquidity of investments in equity securities, company boards and directors need to assure shareholders (including NIMS) that continuing listing of their companies will be their top priority on pain of punitive punishment for failure. Penalties may include provisions to disqualify the directors of the defaulting company from being or becoming directors of other listed corporations, unless sufficient cause is shown for the default and expeditious steps are taken by the company to rectify the default.
Disproportionate Voting Rights

2.113 Joint Stock Company as a form of business organisation is based on the principle of one share-one vote. While non-voting shares and shares with disproportionate voting powers have been (and are) in vogue in some countries, there is increasing recognition of their inequity. To the extent that such disproportionate voting rights dilute the voting value of the shares held by others, companies and particularly controlling/managing shareholders may, sooner or later, have to forego this otherwise very useful device. Indian law does not permit issue of shares with such disproportional voting rights, and this salutary situation needs to continue unchanged.

Shareholders Meetings

2.114 Given the country-wide geographical spread of the shareholding population, the present legal requirement of holding shareholders meetings in the city of the company's registered office location is inimical to larger participation, particularly in the case of dispersed minority shareholders. Listed companies should consider the following alternatives:

- Hold the meetings as at present at the registered office location, but in addition, conduct a shareholders communication meeting once a year at every location where at least 10% of the shareholders (by number) reside. These meetings may not have the status of shareholders meetings prescribed under the companies legislation, but would be in the nature of interchange of views and communication of company policies and business position for purposes of greater involvement of minority shareholders. These may be the first steps of a company towards reaching out to its smaller investors outside of their registered office base.
• Hold the shareholder meetings in a location where the largest proportion of shareholders by numbers (not shareholding) are resident, and simultaneously provide for polling booths under independent professional supervision where at least 10% of the company's shareholders by numbers are resident, where participating shareholders may vote on various resolutions.

• Given the advances in computing and communication technologies, hold the shareholders meetings in a principal location as above and provide for simultaneous video-conferencing facilities at all locations where at least 5% of shareholders by number are resident. To begin with, this may be tried out by listed companies such as those in Group A of the Bombay Stock Exchange.

2.115 Of course the larger participation cannot be allowed to be used as a process to interfere with management decisions.

2.116 In these days of electronic voting machines and other such devices, it should be possible to transmit the voting results at each location to the centre where the central shareholders meeting is taking place, so that the results of each resolution could be announced taking all the votes into account. Further refinements could include allowing distant-location shareholders to participate in the proceedings. These suggestions may sound futuristic but they are not entirely novel. There are of course safeguards that need to be put in place to ensure orderly and legitimate conduct of these proceedings. Postal ballot, which is another option, may not be very suitable on a large scale given its potential for abuse and virtual impossibility of any worthwhile independent supervision. KMB report has set out an approval of postal ballot in respect of certain key issues but it may be desirable to progress in this matter with utmost caution.

2.117 Even these recommendations do not address the needs of shareholders residing in clusters of less than 5% by numbers, but a line has to be drawn somewhere. Access to net based computing is becoming increasingly available and popular; may be in course of
time, voting on company resolutions may be done through this medium from wherever the shareholder is located, with suitable security safeguards and the company bearing the cost of such voting exercises. (a small price for better shareholder participation!)

**Guidance/Debate on Company Resolutions**

2.118 Shareholder guidance on matters relating to their companies is not at present of any reliable independent standard. Minority shareholders, particularly, have to rely on the data provided by the company (which can be one-sided) or depend upon their brokers and friends. There is also a general feeling that minority shareholder votes are not a material part of corporate democracy such as it is now, and this perception together with the required investments in terms of time and money are often the cause of indifference to company meetings and matters.

2.119 There are some possible options to address this situation that can be actioned using web-based media and/or other print/electronic media.

- Companies can post on their web sites reasoning and justifications in support of the resolutions that are due for voting at company meetings. These can be more detailed than what is required by law as explanatory notes supporting resolutions.

- Company CEOs and other members of the Board could "talk" to the shareholders in support of the resolutions.

- Institutional and other major investors can also post their reasoning and justification either in favour or against the resolutions (Incidentally, from the Institutional Investors' viewpoint, this is a major transparency initiative on their decision making and communication processes, and is to be commended to them).

- Financial analysts, investment advisors, and other interest groups may also post their reasoning in support or against, from their respective viewpoints.
2.120 With such information in their hands (either through the web or print/electronic media) minority shareholders will be better informed on the issues and vote accordingly. Clearly, there will be security issues that need addressing by companies to ensure that no unauthorised position statements or other observations find their way to these web sites.

2.121 As regards the answers given at the AGM to questions raised by shareholders, the Companies Act provides for all the information which are to be statutorily furnished to shareholders. Therefore, it is inappropriate to furnish any other information at the AGM. Information furnished should be of a classificatory nature and such information should thereafter be publicised through written communication to all shareholders to provide equity between those who attend and those who cannot attend the AGM. For similar reasons of equity, considerable caution is needed in providing information on the company’s web site even if it is technically feasible for most companies to be so. No information should be furnished which is not statutorily required; otherwise those who have access to the web site will be in a better position than shareholders who have no such access.

**Voting Procedures**

2.122 The next major concern is to make the voting transmission process as easy and reliable as possible. Until a comprehensive system similar to the proxy statement and voting methodology in the US is developed with suitable adaptations for the country, minority shareholders’ votes or present proxy forms will need an independent, reliable and secure transmission system. Supervisory and oversight services at different locations may be left to qualified professionals such as independent chartered accountants, company secretaries or corporate lawyers. Some of the other options for consideration are:
2.124 There is a move to provide, through legislation, representation on the board for minority shareholders. While the intent is laudable, this is likely to be dysfunctional in practice. As in the case of watchdog groups (discussed earlier), the independence and credentials of potential nominees for the positions will be open to question. The country's experience in case of shareholder associations has been largely unsatisfactory, with vested interests and company patronage frustrating the original objectives. The Board of

- Utilise the services of capital market intermediaries like the Depository Participants (DP) (who handle the demat securities in any case) to collect duly filled in proxy forms and transmit them to the companies.

- Similarly, utilise branch locations of selected banks and insurance companies with their vast nation-wide network of offices to collect the proxy forms and transmit to the concerned companies.

2.123 There are of course a few pre-conditions before this system can work:

- Proxy forms should list the resolutions individually and seek voting in favour, against, or abstaining, not the omnibus authorisation that the proxy forms now provide in many countries including India.

- Suitable safeguards during the collection and transmission process should be put in place. These would include measures to ensure tamper-proofing, sealing of envelopes containing the forms, issue of serially numbered receipts to the shareholders, secure transmission to the company, and so on.

- There will necessarily be a small cost in terms of remuneration and reimbursements to the collecting units; these should be borne by the companies and not passed on to the shareholders.

Board Representation for Minority Shareholders

2.124 There is a move to provide, through legislation, representation on the board for minority shareholders. While the intent is laudable, this is likely to be dysfunctional in practice. As in the case of watchdog groups (discussed earlier), the independence and credentials of potential nominees for the positions will be open to question. The country's experience in case of shareholder associations has been largely unsatisfactory, with vested interests and company patronage frustrating the original objectives. The Board of
Directors must be highly action oriented in the age of competition. Minority shareholders can seek and abuse Board positions to subvert a company's competitive ability. Minority investors are best protected by independent directors and by routing their investment through mutual funds. The history of the last 50 years has adequately demonstrated the limited role of legislation and regulation.

2.125 Besides, once a person is appointed a director on the board of the company, he or she is obligated to look after the interests equitably of all shareholders. Requiring any minority representative director to protect the interests of only his or her constituency will be militating against this general principle.

2.126 The best way to protect minority interests still appears to be through legislation and regulation, supported by independent directors on company boards.

**Listed Public Sector Corporations**

2.127 With increasing privatisation measures, more and more companies in the public sector would function as listed corporations with institutional and retail shareholdings in additions to the government's own. Reference has also been made already to the protection needs of the vast stakeholder clientele in public sector enterprises, whether listed or not.

2.128 To the extent that such corporations are governed by companies legislation, it is necessary to clarify governance requirements and the mutually complementary roles of different legislative, monitoring and assurance agencies that bear upon their functioning. The effort should of course be to usher in governance practices of the highest standards while at the same time offering them enough elbow room to function and respond in a businesslike manner.

2.129 At present, such corporations are subject to audit by firms of practising chartered accountants, and by the staff of the Comptroller and Auditor General. In addition, these
companies have their own internal audit and assurance departments, besides also being subject to independent vigilance officers. There is often criticism that too many of such surveillance and assurance agencies tend to interfere with the business operations of the companies and in particular, they promote a culture of defensiveness, inaction, and risk-aversion, none of which is conducive to efficient business management. In this context, whether the set out objectives could be achieved without unduly interfering with normal business operations of such companies is a subject for fresh examination.

2.130 On the audit front, it may be appropriate to prescribe either independent firms of chartered accountants or the CAG to do the audit of the company, as may be decided upon by the board of directors and approved by the shareholders. The boards may be guided by the recommendations of the CAG on the selection of independent auditors but should be free to decide upon the eventual choice. The chosen auditors' report should be addressed to the shareholders as in the case of other private sector companies and there need not be any supplementary review of such reports by the CAG. Where the CAG is appointed to audit the company's accounts, such audits should be performed within time frames applicable to other companies and auditors, and as far as practicable, should be governed by accounting and auditing standards that are applicable to other such companies and audits. Such a dispensation will bring all listed public sector companies under similar audit regimen, minimise duplication of effort not only on the part of auditors but more importantly on the companies themselves, and generally bring them in line with normal commercial disciplines of doing business.

2.131 The internal audit function is an important instrument for board surveillance and executive control. It is recommended that these arrangements continue on lines similar to those applicable to private sector companies. The Audit Committees of the boards of the respective companies should be entrusted with the tasks similar to their counterparts in other private sector listed companies, and ensure that the independence of the internal audit function, its resources and expertise, and other such matters are duly taken care of.
2.132 The concepts of vigilance and ethical conduct in business operations are valid and every effort should be made to ensure that deviant behaviour is detected and dealt with, and in fact to the extent possible pre-empted. The need for a separate independent vigilance organisation however needs to be revisited. Organisational control systems should be designed to root out unacceptable behaviour through more transparent processes and vastly reduced discretionary authorities. Except in specific (and hopefully isolated) instances where the board could ask for a special investigation, the company's internal control structure and systems and periodical internal audit assignments should be geared to prevent unethical or unacceptable behaviour.

2.133 This is however not to minimise the importance of formalised commitment to normative behaviour of the highest standards. Mention may be made at this point of the exemplary work done in the United Kingdom in the 1990s when a committee under the chairmanship of Lord Nolan published a document setting out standards of behaviour in public service. This body has now been constituted as a permanent committee with full time members researching and offering guidance in this field. In India, there is a code of conduct for the civil service. A draft code of ethics for public sector enterprises and concerned administrative ministries was prepared by the then Chairman of the Public Enterprises Selection Board (now Chief Vigilance Commissioner) Shri N Vittal. It may be appropriate now to constitute a committee to consider and prescribe a code of behaviour and ethics applicable to public sector enterprises which can be adopted by company boards for enforcement within the organisation. This process need be no different from that adopted in domestic and international organisations well known for their probity and business practices.

National Listing Authority

2.134 There is a disconnect at this point of time between listing and trading of a company's securities on stock exchanges. There are companies listed on relatively obscure stock exchanges with very little trading activity, but actively traded on a different
stock exchange like the NSE. Without actual listing, there is no obligation for such companies to fall in line with the disciplines of the exchange where they are traded.

2.135 With due regards to regional aspirations and the attraction of a listing fees that stock exchanges obtain from companies, it must be recognised that listing is an important signal of credibility and liquidity in the perception of investors and there needs to be some central agency that would ensure only appropriate companies are granted a listed status. Legacy and laxity in granting and continuing listed company status to several thousands of companies are the root. Causes for many ills of the capital markets, such as the phenomenon of vanishing companies, the Z category on the Bombay Stock Exchange, thin or no trading in case of several hundreds of listed companies, and so on.

2.136 There is thus a strong case for setting up a National Listing Authority (NLA) for granting listed status to companies on transparent and stringent criteria. Listing fees may be abolished or greatly minimised (much to the disappointment, of course, of dependent stock exchanges) but their revenue could be linked to trading volumes and values. If listing fees are to be retained, they could be collected centrally by the NLA and a major part of this revenue may be distributed to the stock exchanges on the basis of trading activity in the company's scrips. Once so listed, such companies must be required to fall in line with the requirements of each stock exchange where their securities are traded.

2.137 Administratively, it may be convenient to locate the NLA at SEBI or one of the leading stock exchanges like NSE or BSE, with the clear understanding that listing is a national license for securities trading on different stock exchanges where the company requests for trading facilities. NLA could also introduce and administer a scheme of continuing accreditation on a bi-annual basis to ensure listed companies earn the right to retain that status on the basis of their performance and compliance with prescribed requirements. De-listing should involve significantly punitive punishment to the executive directors of the company, while ensuring protection of shareholders other than those in dominance or control.
Voluntary De-Listing of Companies

2.138 India has the dubious distinction of international leadership in terms of the number of listed corporations, even though it lags behind substantially on other parameters such as market capitalisation or trading volumes. Most of these listed companies especially in older stock exchanges such as those in Bombay, Calcutta and Delhi, have obtained their listed status for tax and other reasons, while a substantial number probably did so, and continue to do so, for the limited purpose of accessing capital from an unwary public. The number of vanishing companies and those whose securities are hardly if at all traded on the bourses is alarmingly high. So are the cases where companies have defaulted in their compliance of listing agreement requirements.

2.139 De-listing of course hurts minority investors more than it does the shareholders in control or dominance. This is the reason why a leading exchange like the BSE has created a Z category of companies to put them under watch and investors on alert rather than outright de-listing them.

2.140 More stringent corporate governance requirements currently under implementation and those under consideration would in all likelihood expose the lack of intent or capability on the part of many listed companies in terms of their falling in line with the tougher regime. Rather than having a dysfunctional and defaulting population of such companies enjoying the Listed status without the means to discharge associated responsibilities, it may be better to undertake a once-off clean up exercise, literally, to separate the chaff and retain the wheat. International standing of Indian listed companies would only be strengthened by this process, and in due course of time may even lead to a rating status comparable with other well respected capital markets.

2.141 The critical pre-condition for any such scheme however is the protection of retail and institutional investors in such companies. The promoters or the identified dominant group should be asked to buy back the shares of investors desiring to do so, at a reasonable price. What is reasonable is open to debate, and may have to be evaluated by
professional valuers in individual cases. Even if it is less (as is likely) than what the shares are really worth, frustrated shareholders may find it an attractive exit option. In case of willing companies that are genuinely unable to incur associated costs of the scheme, perhaps the government together with the stock exchanges and SEBI could provide for a "exit fund" that could be transparently used for the purpose. The exit route should of course be approved by the shareholders of the company, adopting for this purpose the concept of interested shareholders recommended earlier, with the dominant/controlling shareholders not being permitted to vote on the proposal and its terms of buy back etc.

2.142 Companies that do not opt for such a scheme within a prescribed timeframe should be subjected to the usual governance requirements, and defaulters should after that period be subject to penalties and other punitive measures that apply in such cases.

2.143 The Task Force appreciates that such a scheme would face the same kind of criticism that other voluntary exit schemes are subjected to but makes this suggestion regardless, in the hope that it will enhance the stature of the real corporate India and will led to a general upgradation of corporate governance standards and their compliance in the country.
As the OECD governance document suggests, that it is indeed advisable that corporations be allowed to concentrate on their task of achieving their economic objectives, but the varying stages of development in different countries may dictate a diversity of approaches towards achieving objectives that may not be strictly economic.

3.2 Corporations need to reconfirm and reiterate to themselves that they operate within a society, with its sanction and authority, and ultimately for the common good of its largest part, not just for itself or its shareholders, employees and managers alone. Without this understanding, there will be no social cohesion between and among government, business and society. When there is complete understanding and appreciation of these imperatives, the country, and business as a sub-set, will thrive. Without it, there will be social chaos with different constituents pulling in diverse directions. Instead of fighting competition from outside, the constituents will be competing among themselves for a more than just share of the fruits of their industry and endeavour.

3.3 As the OECD governance document suggests, that it is indeed advisable that corporations be allowed to concentrate on their task of achieving their economic objectives, but the varying stages of development in different countries may dictate a diversity of approaches towards achieving objectives that may not be strictly economic.
This is where corporations with their managerial, financial and other resources and strengths need to step in and help in the process of achieving growth in desired directions.

3.4 Four stages have been identified in what is inherently a continuum between the two extremes of responses to societal demands. At one end is the total denial of any responsibility towards society. The next stage of progression is the initial recognition of some responsibility. Discretionary philanthropy falls into this category. At the next milestone, corporations reactively engage in discharging social responsibilities. These could be the result of legislative or regulatory requirements or even societal protests and activism. While not the most graceful method of discharging social responsibilities, it is nevertheless a better proposition than taking recourse to legal loopholes or other such devices to repudiate or at least delay and frustrate eventual obligations. The fourth and final stage is the proactive engagement where corporations strive to achieve leadership in conceptualising, assessing, and addressing societal obligations on their own initiative and without legal or activist props. This is a state of corporate nirvana, one that is difficult to achieve particularly in societies less than well governed politically, but once reached, bestows on the corporation incomparable perceptions of value. Several corporations internationally have made significant progress towards this exalted state, having taken the lead in following high-principled policies relating to business ethics, child labour, workplace safety and comfort, user safety in products and services offered, environmental protection and regenerative sustenance, and so on. There are several Indian examples: organisations that run townships administrations those that contribute to National efforts in mitigating hardships like floods, droughts, and earthquakes, those that achieve comprehensiveness and transparency in financial reporting equaling the best elsewhere, others that implement schemes providing succour to their employees not otherwise covered by insurance or other such protection.

3.5 Businesses impact on society in three ways. They impact society in environmental, social and economic dimensions. In the first category fall items such as emission and waste control, energy usage, product life cycle/ recycling, and sustainable development. Social impact would cover areas such as equal opportunities, community
regeneration, human rights, education and culture, and so on. Wealth generation, (productive) job creation, ethical business practices, avoiding corruption and bribery, and enhancing product value would constitute the elements of economic impact. In each of these areas, the way a corporation chooses to act will determine its claim to good corporate citizenship or otherwise.

3.6 The best form of such social responsiveness is adequate performance within the company own aims and objectives. Ethical value addition and ensuring equitable distribution of value among all legitimate stakeholders is the most important aspect of social responsivity. It is also very important for a company in discharging its social responsibility to retain a totally secular outlook towards social contributions and donations etc., A company may benefit a particular charitable or social cause but it is doing so with shareholders' money and some of the shareholders may not wish their funds to be utilised for that purpose. A company serves society best if it acts ethically and efficiently.

3.7 Three main ways have been suggested for corporate creation of societal value-add:

- first, and most important, through efficient and ethical pursuit of their core business activities, both in the workplace where they have direct control, and along the supply chain where they have a mixture of control and influence

- second, through social investment and philanthropy, not just giving money to local charities but also through sharing the company's competencies as part of the programme, and

- third, by contributing to the public policy debate, through helping government and other bodies develop appropriate fiscal, regulatory and institutional structures that facilitate achieving desired objectives.
3.8 The emerging message to corporations seems quite clear. Take care of your customers; do not ignore your suppliers. Your employees are your most important partners in the wealth creation process: share your potential prosperity with your people. Meet your debt service obligations promptly and on schedule. All these are imperative in ensuring shareholder wealth maximisation, which is indeed the primary goal of the corporation. Companies must focus on their prime responsibility to the shareholders, the owners of the company. But in order to sustain such achievements, working within and as part of society is all-important, failing which society will reject the socially unconscientious corporation, often sooner rather than later. Such are the challenges and opportunities for corporations in quest of world class standards of excellence in the twenty first century.
Part IV
Legislation, Regulation and Voluntary Initiatives:
Recommendations Relating to Corporate Governance Matters

4.1 This part sets out key corporate governance initiatives that need to be introduced, either through legislation, regulation, or voluntary codes, or by a combination of these. In tune with the spirit of governance initiatives being part of the corporate ethos of the country, and based upon experience elsewhere in the world, it is advisable to limit legislative interventions to the minimum, leaving adoption of such measures on a voluntary basis by corporations themselves as dictated and demanded by mature market forces. Until such maturity is achieved, it will be inevitable that a large part of the requirements of good governance will have to be covered by legislation and regulation.

4.2 In the interests of clarity, the following recommendations assume acceptance of their underlying principles elaborated in discussions in preceding Parts of this Report. They should be modified and redrafted appropriately, in the event some of these initiatives are not accepted for implementation.

4.3 Suggested measures have been grouped in two categories, appropriately indicated. First, Essential measures (E) that are recommended for inclusion in corporate legislation, and Second, Best Practices (BP) that are intended to be recommendatory and for inclusion in a Table of Model Corporate Governance Measures that may be adopted by companies at their option with or without modification.

4.4 The change process is tortuous and time consuming. Many companies may not be geared for the change both in terms of mindset and physical resources. A phased implementation schedule has been suggested that would help companies to introduce
recommended changes gradually. Three categories and effective implementation dates are proposed:

Category A companies comprising of those included in Group A of Bombay Stock Exchange and the S&P CNX Nifty index as of January 1, 2001 and unlisted companies with shareholders funds of more than Rs.100 crores, or annual sales/service revenue of more than Rs 100 crores: Effective in respect of accounting years commencing on or after April 1, 2001

Category B companies comprising of all other Listed companies and unlisted companies with shareholders funds of more than Rs.50 crores, or annual sales/service revenues of more than Rs 50 crores: Effective in respect of accounting years commencing on or after April 1, 2002

Category C companies comprising of companies seeking listing for the first time: Effective in respect of accounting years in which they are listed

4.5 One of the recommendations is aimed at enabling inappropriate companies to shed their Listed company status with suitable protection to shareholders. Should a company opt for this scheme, it is recommended that they be exempted from the responsibility of implementing the proposed governance provisions during the interregnum.

Recommended Measures

4.6 General

(E) (1) A Model Code of Best Practices in Corporate Governance be appended to the Companies Act, on the lines of Table A (model articles of association), for adoption with or without modification, by companies at their option.
(E) (2) To the extent possible, Governance issues be collected together and placed in a separate Chapter, preceding the Chapter on Management & Administration.

(E) (3) A clear distinction be made between direction and management, with the board being charged with responsibilities relating to the former, and the executive with the latter.

(E) (4) At present, companies are categorised as public and private; the first category be further refined into listed and unlisted public companies, to be clearly identified in their company names by the addition of a suffix, Lple and Uple, respectively standing for Listed public limited company and Unlisted public limited company. These will replace the present single-word description, Limited, after the company's name.

(E) (5) Make the most rigorous governance standards applicable to Listed and large unlisted companies, apply less rigorous but basic minimum governance standards to smaller Listed and Unlisted public limited companies

(E) (6) Offer a transition period and facilities for presently listed companies to get themselves unlisted, if they so desire, ensuring that the non-promoter-non-dominant institutional and non-institutional shareholders' interests are protected in the process.

4.7 Company Boards, Directors, & Processes

(E) (7) Prescribe a minimum of five directors in case of Listed companies, and retain the present number of three for Unlisted companies. Apart from this, the size of the Board be left to the discretion of the company and its shareholders.

(E) (8) The Board of a Listed company should at all times have a majority of independent non-executive directors. Define independence to mean absence of
any material pecuniary or other relationship that could impair the person's exercise and freedom of judgement in all matters relating to the company. Also provide for discretion to the full Board (with all directors concurring) to decide on the independent status of a person despite presence of such relationships in specific cases, with a disclosure requirement in the company's annual reports and in explanatory statements proposing appointment or continuance of such persons as directors, the reasoning of the Board for reaching such a conclusion.

(E) (9) The positions of Board Chair and Managing Director of a Listed company should be separated, but the company may have the option to combine these with the disclosure requirement in company annual reports and in explanatory statements proposing or continuing such an arrangement the reasoning that led the Board (with all directors concurring) to take that decision and measures proposed.

(E) (10) Every Listed company must be required to constitute an Audit Committee and a Compensation Committee consisting of a minimum of three members, all of them being independent non-executive directors. The Chair of the Audit Committee should be a person with knowledge (by qualification or experience) of finance and accounting. Minimum requirements as to the powers and authorities of these Committees should be either set out in the Act itself, or left to be prescribed from time to time by the Securities and Exchange Board of India.

(E) (11) Both the Committees are creatures of the Board and should be subordinate to the authority of the Board. The Board should therefore have the authority to override any decisions of the Committees. In the interests of professionalism and transparency, where the Board disagrees with any material decision of the Audit Committee, there should be a disclosure requirement in the annual reports to set out any such instances together with the reasoning of the Board for such decisions.
(E) (12) Executive directors such as Managing Directors and other whole time Directors of Listed companies should be barred from taking up any other position as executive director, managing director, or whole time director in any other company, whether Listed, Unlisted, or Private. Subject to the prior approval of the Board (with all directors concurring), they may accept other non-executive directorships in no more than two other Listed companies, be a board chair in no more than one such company, be a member of no more than two committees and shall not accept chairmanship of either the Audit Committee or the Compensation Committee of such other companies.

(BP) (13) Audit Committee of listed companies should adopt a written charter approved by the Board, specifying the scope of the Committee's responsibilities, and how it carries out those responsibilities including structure, processes, and membership requirements. Annually, the Committee should review and reassess the adequacy of its charter. Annually, the Chair of the Committee shall submit a report (to be appended to the directors' report to shareholders) covering matters such as whether the Committee has a written charter and whether it satisfied its responsibilities during the year in compliance with its charter. The written charter of the Audit Committee shall be published in the first annual report to the shareholders immediately following, and thereafter repeated every three years. Any material changes to the published charter shall be disclosed in the annual reports during the intervening years. The current version of the charter and details of amendments made to the original version shall at all times be displayed on the web site of the company.

(E) (14) The Audit Committee of a Listed Company shall have the authority to seek and obtain from the statutory auditors, and the cost auditors, such auditors shall be obliged to provide upon such request, an account detailing all relationships between the auditors on the one hand, and on the other, the company, its subsidiaries, its promoters or dominant shareholders in management control, and any associates or subsidiaries controlled by such promoters or dominant
shareholders. The auditors should also affirm their independent status, and in case of any relationships that in the opinion of the Audit Committee or the auditors, may materially impact upon their independent status, how the auditors propose to correct the situation.

(BP) (15) Except with the prior approval of the Board (all directors concurring, and the interested director abstaining), no executive director of a public company, Listed or Unlisted, shall accept a directorship in any other company, including private limited companies, partnership in firms, or on his/her own account be, engaged in activities directly in competition with the first company, in material lines of its business. Non-executive directors may accept other non-executive directorships in competing companies as defined herein subject to their disclosure to the board and undertaking that they shall abstain from discussion and decision on matters with potential perceived conflict of interest. The Board should be required to disclose in their annual report any instances where a discretionary exception is made in case of an executive director and their reasoning for doing so. In annual reports, the board shall disclose the names of directors holding directorships in such competing companies and the names of such companies.

(BP) (16) No director of a Listed company may be appointed as the chair or a member of that company's Compensation Committee, if he or she serves as an executive director or officer of another company whose Compensation Committee includes as Chair or as member any of the executive directors including the managing director of the first mentioned company.

(BP) (17) Every Listed Company shall constitute a Nominations Committee, consisting wholly of at least three independent non-executive directors, charged with the responsibility of scanning on a regular basis for potential candidates to be appointed to the Board, both in executive and non-executive positions, should an opportunity arise for additions or replacements on the Board.
(BP) (18) Subject to the statutory ceilings on overall number of directorships, no non-executive director of a Listed company shall be eligible to serve as non-executive directors of more than 14 other Listed companies, as members of more than ten committees of such companies of which no more than four shall be audit committees, or chairs of more than four committees of which no more than two shall be audit committees, or as board chair in more than five Listed companies.

(BP) (19) Boards of Listed companies may have nominee directors representing any authority, institution or organisation including central and state governments, only when required or permitted by law or other mutually agreed covenants. Otherwise, all directors of Listed companies shall only be elected by their shareholders in general meeting.

(BP) (20) Nominee directors on Listed companies shall not qualify as independent directors except where such nominees do not have any material pecuniary relationships with the authority, institution or organisation nominating them, or with any other person or body that controls such nominating entity.

(E) (21) The present expression *managerial remuneration* used in the Companies Act to describe payments made to executive and non-executive directors needs to be expanded to *directorial and managerial remuneration* to adequately reflect the duality of governance functions relating to direction exercised by the Board and management exercised by the executive.

(E) (22) Subject to shareholders' approval and within the prescribed overall ceiling on aggregate directorial and managerial remuneration as a percentage of profits (with due provisions applicable to both executive and non-executive directors, in case of absence or inadequacy of profits), Listed companies shall have complete discretion to fix rewards and remuneration, and methods and periodicity of payments, to their executive and non-executive directors to attract and retain the services of the right kind of people to serve in such positions.
(E) (23) Remuneration to managing (and other whole time) directors may be in the form of, but not limited to, monthly salaries, perquisites commensurate with the position and industry practices, performance related bonuses and commissions, ESOP awards as per schemes approved by Regulators, and so on. The valuation of perquisites for purposes of remuneration calculations should be on a cost-to-company basis, while their valuation for personal taxation purposes may continue to be in line with the tax rules. As a minimum level of remuneration in the event of absence or inadequacy of profits, all the components including performance related bonuses may be retained in full but any profit related commissions may be excluded.

(E) (24) Remuneration to non-executive directors may be in the form of, but not limited to, monthly retainer fees, sitting fees for Board and Committee meetings attended physically or participated in electronically, contribution-based bonuses, profit related commissions, and DSOP awards as per schemes approved by regulators. (A distinction is being drawn between ESOP applicable to employee-directors and DSOP [to be designed similar to ESOP] applicable to non-executive directors.) As a minimum level of remuneration in the event of absence or inadequacy of profits, all the components including contribution related bonuses may be retained in full but any profit related commissions may be excluded.

(E) (25) Stock Option Schemes as currently approved by the regulators provide for a lock-in period of one year. This may be made inapplicable in the unfortunate event of death (other than by suicide) of the awardee, in fairness and recognition of the contributory role of the spouse and family in the awardee's performance when alive.

(BP) (26) In case of Listed companies exercising an option to introduce electronic participation at their board and committee meetings, the quorum requirements should refer to independent non-executive directors or members. In unavoidable exigencies, if such a company is unable to conduct meetings with electronic
participation in any such meetings, the board minutes shall record that fact and indicate the reasons for such inability.

4.8 *Audit, Accounts, Ethics, Disclosure, and Reporting*

(E) (27) Listed companies should publish their annual reports and accounts in a prescribed form (minimum requirements to be incorporated in corporate legislation, in consultation with the Securities and Exchange Board of India, the Institute of Chartered Accountants of India, Institute of Cost and Works Accountants of India and The Institute of Company Secretaries of India) for circulation to shareholders. Specialised and more detailed requirements of statutory and regulatory agencies shall be fulfilled by companies separately. Returns with the Registrars of Companies and SEBI/Stock Exchanges shall be displayed by Listed companies on their web sites, and by the Registrars and SEBI/Stock Exchanges on their web sites for free access to interested parties. DCA and SEBI should be requested to design a full and comprehensive set of returns to be filed by Listed companies for such display on their web sites or any other web sites specifically designated for this purpose, and make available all such filings to the public for information and downloading, free of charge.

(E) (28) The chief executive officer and the chief financial officer of all public companies, Listed and Unlisted, should provide a statement in each annual report to shareholders, acknowledging responsibility for the financials and confirming that they have been prepared in accordance with accepted accounting standards and practices, and detailing with reasons any deviations from such standards or practices.

(E) (29) The chief executive officer, the chief financial officer, and the Company Secretary of all public companies, Listed and Unlisted, should provide a statement in each annual report to the shareholders, confirming compliance with all legal
and regulatory requirements, and detailing with reasons and without admission of any default, any situations of non-compliance.

(F) (30) The Chief Executive Officer, the Chief Financial Officer, and the Company Secretary of all public companies, Listed and Unlisted, should provide a statement in each annual report to the shareholders, to the effect that all statutory formalities have been complied with all statutory dues have been paid and to the best of their knowledge and belief there were no illegal transactions or payments during the period to which the report relates.

(E) (31) The statutory auditors' report to the shareholders should be pruned considerably and brought in line with international practice. A more detailed report to the Audit Committee (as the shareholders' representative body) may be introduced where the statutory auditors and/or cost auditors could provide more information on audit coverage, methodology, opinion and concerns on internal control, and other such matters. Of course, the statutory auditors should be required to qualify their audit certification where warranted by circumstances. Audit Committees should also be free, at their option, to disclose any material concerns and how they are being addressed, in their report to the shareholders. These provisions should be made applicable to all Listed companies.

(E) (32) The requirement of reading out the audit report at shareholders' meetings should be discontinued except for any qualifications in such report.

(E) (33) Listed companies should be required to comply with these requirements from accounting years beginning on dates to be notified.

(E) (34) All documents filed by companies with the Registrars of Companies are open to public inspection and copying with certain reservations applicable to private limited companies. Listed companies (and other companies, preferably) as well
should be required to file these documents in digital format to facilitate display on appropriate web sites.

4.9 *Shareholder Democracy and Protection of Minority Interests*

(E) (35) In case of Listed companies, introduce the concept of *interested shareholders* in the scheme of voting on resolutions by shareholders. While retaining the basic character of the joint stock corporation where voting rights are proportionate to the voting capital held, the proposed *interested shareholders* concept would require all shareholders individually or in groups or categories benefiting from a proposed resolution to the exclusion of other shareholders to abstain from voting on such resolutions. In order that this provision intended to protect minority shareholders, is not abused by a handful of vested interests, its operation should be limited to specific matters such as selective preferential issues of equity shares, setting up competing ventures, and buy-back of shares where a majority or dominant shareholder group stands to benefit. These provisions should be made applicable to cases where the *interested shareholders* constitute 76% or less of the total shareholding by par value.

(E) (36) Listed companies’ annual reports to the shareholders each year, and their documents in respect of any public offer or private placement for subscription to the equity capital of the company, should disclose if, to the knowledge of the Board, any agreements (such as shareholders agreements between dominant or controlling shareholder groups) exist between and among some of the shareholders the benefits of which may not be available to all the shareholders, and if so, material provisions of such agreements.

(E) (37) Disqualification criteria for appointment or continuance as a director of a Listed company should include being, or having been in the preceding three years, a managing or whole time director of a Listed company that was stripped of its Listed company status or segregated and categorised as a defaulting company by
the (proposed) National Listing Authority or the Securities and Exchange Board of India or designated stock exchanges.

(BP) (38) Listed companies should, in addition to holding their shareholders' meetings at the location of their registered office, simultaneously provide polling booths under independent professional supervision, in every location with not less than 10% of the shareholders by number (not value) where such shareholders could cast their votes on proposed resolutions. Secure arrangements shall be made for manning the booths and collection and transmission of the votes to the company secretary at the registered office. Such votes shall be reckoned in case of a poll on any resolution. Listed companies may at their option also provide video-conferencing facilities at locations where not less than 10% of the shareholders are resident, and allow for fully secured voting arrangements and even for shareholder participation in the proceedings.

(BP) (39) Once a year, Listed companies should hold a shareholders' meet at locations where not less than 10% of the shareholders by number reside. Such meetings should be used by the companies to interact with the shareholders to bring about greater appreciation of their companies' plans and performance. In addition to the chairman of the board and the chief executive officer, such meetings should also be attended by the chairman of the Audit Committee.

(BP) (40) Listed companies should provide user-friendly web sites and provide information on an ongoing basis to shareholders and others. Such companies should post detailed explanations in support of resolutions being proposed at forthcoming meetings of shareholders, and shall be obliged also to post position statements received from institutional and other shareholders in support of, or against the resolutions.

(BP) (41) Good corporate governance requires a continuing effort at self evaluation and improvement. There is need for companies to undertake a periodic corporate health check either internally or with professional help in order to ensure that
there is adequate and early diagnosis of symptoms leading to a quest for improvement. Nominations and Governance Committees of Listed companies should undertake this responsibility at least every other year.

BP (42) Corporate Governance in so far as it reflects the responsibility of the Board of Directors must be effective but non-invasive. Annual budgets and the process of periodical reviews and control and an appropriate information system and an appropriate cost and management information system can help the board in general and its non-executive members to contribute to the performance of the company without seeming to interfere with its management.
5.1 Corporate Governance issues are beginning to be taken more seriously in recent times. This is due to several factors: the much greater awareness and activism of shareholders for better and more transparent direction and management of their companies, an increasing demand for greater accountability in the face of a series of corporate failures, pressures on the regulators to provide a meaningful protective environment to safeguard the interests of shareholders in general and small investors in particular, and of course, a wider recognition on the part of company managements themselves, of the need to become competitive and attractive in terms of ability to globally access capital and compete in business. In addition, there are mounting pressures for accountability to other stakeholders as well.

5.2 Corporate Governance Issues fall broadly under three categories: first, accountability of the directors and managers of a corporation to their shareholders and other stakeholders, including accounting and reporting policies and practices and associated transparency; second, role and responsibilities of the board of directors and best practices that contribute to the meaningful discharge of these responsibilities; and third, the role of the regulators, investors, professionals and professional bodies, and ultimately the government and society at large in bringing about desired standards in corporate governance. Under each of these broad heads, there can be several areas and avenues for specialised research to support policy initiatives.
5.3 A number of initiatives that are already in place or well under way. Books and articles on the subject have been published. The Confederation of Indian Industry brought out in April 1998 a Desirable Code of Corporate Governance, which is currently under updation and revision. The Kumar Mangalam Birla committee of the Securities and Exchange Board of India has published in 2000 its report on corporate governance and many of its recommendations have been actioned through the Listing Agreements between Stock Exchanges and Listed Companies. Management Institutes at various locations that were set up to propagate management education have done a commendable job in recent decades. It is now necessary to take these initiatives forward on an all-India basis into the area of overall corporate governance to enhance the competitive capability of Indian Companies in a globalised context.

5.4 Corporate Excellence not being a one time effort or exercise but being a continuous one, the parameters for achieving excellence to be observed by the corporates ought to be closely monitored and administered. Here arises an imminent need for establishment of a separate Centre to function as the repository of knowledge on Corporate Governance issues. The Task Force considers that there is an urgent need to set up an independent autonomous Center to be called Centre for Corporate Excellence in the country. The Department of Company Affairs as the nodal government unit concerned with the administration and management of the Corporate sector should now take the necessary initiatives to process setting up this Center. Such a Center should be the 'knowledge portal' on the subject. The Task Force felt that setting up of a Chair for corporate governance or a separate wing in an existing institutions may not serve to provide the required focus and thrust for this movement. The Task Force recommends that the proposed Centre be set up as an autonomous body and be entrusted with three broad groups or wings of activity as under:

1. Research and Studies
2. Education Promotion and Development
3. Accreditation and Awards
5.5 The Task Force felt that, in so far as the function of accreditation is concerned, it may be implemented by an independent division or organisation under its supervision, so as to ensure its own independence and credibility can be maintained at the highest levels. Accreditation will include certification of companies who practice acceptable standards of corporate governance, institution of annual awards for outstanding performance in this area and undertaking any consultancy work as required by companies, regulators, government and others in the area corporate governance.

5.6 This Centre or its agency could examine the credentials of companies seeking such a recognition and accord suitable certificates to those who are worthy of them on the basis of their adopting good practices of corporate governance. A company receiving such a certificate would be able to display it in all its publications and also on its prospectus, applications to Bankers and financial institutions, etc. The certificate would have a validity period and would be subject to renewal on the basis of continued assurance of good corporate practices.

5.7 This Centre or its agency can give National awards for companies with very good corporate governance practices. It can also issue commendation certificates and shields to such companies. In all these matters, it will be a good practice to appoint independent panels of judges and advisers of eminence in the field so that the results are seen to be objective and praiseworthy.

5.8 In the course of performing its functions, the Centre should also encourage research and development activities. It should hold seminars and conferences, educational programmes and symposia, etc. For this purpose it should draw upon available resources both domestic and international. It is recommended that the Centre is structured as an independent body to ensure its contributions are unbiased and apolitical.

5.9 The institution will thus be the focal point of research on issues bearing upon corporate governance, such as Board of Directors, their Operation and Performance, Committee Procedures and Processes, Reporting Norms, Ethical Management,
Stakeholder Claims, Privatisation and Disinvestment Policies and Practices, Capital Market Reforms, and so on. The research agenda could be extended to cover governance in public sector, organisations, centre and state governments, non-government-not-for-profit organisations, quasi-autonomous non-government organisations, academic institutions and universities and so on.

5.10 As regards locating such a prestigious Centre, the Task Force after considerable discussions on various positive as well as negative aspects regarding metropolitan versus non-metro but mega cities, is of the firm view that it should be located not in any of the present metros in view of their high congestion and severe bottlenecks but locate it in one of the mega cities like Bangalore or Hyderabad or Pune or Ahmedabad or Lucknow or Indore or Coimbatore as each of these cities provide ample scope for sufficient and congenial location site which should be like any IIT or IIM campus. Further, such mega cities would be in a position to provide the required infrastructure facilities. A Centre like this to bring about excellence in the functioning of corporates should be run by people who themselves are excellent. Such right talents could be tapped only by locating the Centre in a place which is likely to provide infrastructural facilities such as roads, power, water, adequate space, easy accessibility and also offers a safe and pollution free environment.

5.11 The Task Force looked at the cities for suitability viewed from the above requirements and narrowed down the location of the Centre to either (a) Bangalore or (b) Pune or (c) Hyderabad or (d) Ahmedabad in that order. The Task Force also noted the considerable amount of work being done in the area of corporate governance in IIM, Bangalore and has ultimately identified Bangalore as its first priority for locating the Centre and recommends accordingly.

5.12 The Task Force considers that in view of the urgency to set up this Centre it is not desirable to go in for a greenfield option. The Centre can be set up immediately and allowed to make use of the infrastructure facilities and faculties of other renowned institutions located in the place.
5.13 The Task Force felt strongly that for the Centre to function effectively it should have full functional autonomy in its financial, academic and administrative work. The Centre should be headed by a Director who should be a person of stature selected by a collegium of eminent persons which may include the following:

1 Secretary, Department of Company Affairs
2 Directors of IIMS (at least 2)
3 Nominees of CII, ASSOCHAM and FICCI
4 Representatives of Professional bodies like ICSI, ICAI and ICWAI
5 Representative of National Law School University of India, Bangalore

5.14 The Task Force feels that the Centre should start with a corpus of Rs.50 crores and funded by the Chambers of Commerce and Industry in India, so that it is self sustaining. It should not be funded by any individual company but it can charge fees for any consultancy work it may render to companies.

Education & Research Wing of Centre for Corporate Excellence

5.15 A number of areas have already been enumerated for policy research and support in different fields of corporate governance. Two important areas for training and development with a practical bias, however, need special mention. The first concerns corporate directors and the second the field of internal audit and assurance. Both are important constituents of corporate governance initiatives and it is proposed that the CCE addresses them with utmost dispatch.

Corporate Directors

5.16 The tasks of company directors are increasingly becoming onerous and broad based. This trend is only likely to continue unabated, given the demanding requirements of higher standards of corporate governance worldwide and in India.
5.17 On the one hand, companies will be looking for competent and independent persons of professional excellence and personal integrity to populate their boards. On the other hand, the trend towards fewer directorships and committee memberships would gain further momentum to enable independent directors to focus on the affairs of their reduced number of companies to be able to deliver. The demand-supply gap in the field of trained independent professionals available for board positions in listed corporations is thus likely to be of a significant magnitude in the near future. The transformation processes towards greater professionalisation taking place in family controlled business is also likely to compound this problem even further.

5.18 It does seem that there is a pressing need for an institutionalised framework creating a nucleus organisation where full time and non-executive directors including those aspiring, or being groomed for such positions of responsibility may have a window on what is happening around the world, and to prepare them to shoulder the increasingly onerous responsibilities. Similar organisations such as the Institute of Directors in the UK and the National Association of Corporate Directors in the US, exist elsewhere for providing training and professional and research support to corporate directors.

5.19 Therefore, it is recommended that the Education and Research wing of the CCE be entrusted with the task to provide such support. Detailed constitution, coverage, activity profiles, possible affiliations with international bodies of similar objectives, and so on need to be worked out, but the initiative deserves immediate consideration.

**Internal Audit and Assurance**

5.20 A major constituent of corporate governance is the responsibility of the board of directors through their audit committees to ensure that appropriate systems are in place and are operating satisfactorily. Recent developments have expanded the scope of these responsibilities to all forms of risk and control applicable to an organisation's activities,
not just internal control alone. Company legislation in India had recognised the importance of internal audit in corporate management and control and had mandated an internal audit function in medium and large sized companies and had required the statutory auditors specifically to comment upon whether such companies had in place a commensurate internal audit function.

5.21 Application of information technology has in its wake brought in new dimensions of risk bearing upon white-collar crime and computer based frauds. Several other business risk including financial and treasury management risks are becoming important in a competitive and liberalised business environment. All these highlight the need to develop a high level of professionalism and expertise in such diverse fields.

5.22 While a vast majority of internal auditors have an accountancy background and in fact several accounting firms in practice have wholly or substantially developed their internal audit and assurance practice, this growing field deserves to be better organised to develop, train, and eventual certify specialised management professionals in this field. Several leading institutions exist worldwide focusing upon financial, operational, management, systems, risk, and other audit skills and expertise, and many of them have country chapters or units in India. It is recommended that steps be taken to constitute an Internal Audit and Assurance Cell as a separate wing of CCE to coordinate and build upon these efforts, provide professional guidance, and promote research and publications of material of value to the audit and assurance functions not only in the private corporate sector but also in state owned enterprises, quasi autonomous organisations. In course of time, depending upon the developing needs of the times, this organisation may also be geared to conduct certifying examinations and promote professional membership of persons in this field of specialisations. Giving due recognition to basic qualifications and experience in the constituent disciplines such as chartered accountancy, company secretarial, engineering and management, systems development and management, risk management, and so on. The objective will be to provide specialised focus on corporate governance, audit committee processes, control mechanisms and their management, value based surveillance, and so on.
Conclusion

The Task Force is of the firm belief that the observations ad recommendations contained in this Report would be appreciated in the proper spirit in the interest of achieving corporate excellence which in turn would lead to a wholesome growth of the corporate sector in India.

Sd/-
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CHAIRMAN

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P M NARIELVALA
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PROF. N BALASUBRAMANIAN
CO-OPTED MEMBER

Place: New Delhi
Date: 20th November, 2000
Corporate Governance in USA is the Anglo Saxon system which is very much based on the individual and short-term market orientation. Historically speaking the US ownership and governance structure by and large is dominated by large public corporations, most of which have dispersed shareholders with small percentage holdings and relatively little or no voice in corporate governance. It is interesting to note as to how such a fragmented corporate ownership structure came up in the US. The primary reason for the prevailing form of American business is a matter of international historical economic revolution. Initially, the American corporations raised money from the small investors and over a period these corporations witnessed shift in ownership pattern from the fragmented one to the ownership of domestically located institutions. 100 years of latent American financial history is a witness of these developments. However, ownership concentration of power in the hands of institution has become a matter of challenge to the corporate governance.

It is difficult to evolve any panacea which could cure the ailments of American corporate governance. Increased institutional power could lead to political pressure for more Government intervention, which has tended not to work poorly elsewhere. America being the focus of investments and international trade is capable of absorbing multiple governance system. The policy prescription for USA, therefore, by researchers has been that they should be thrown open to more competition and the resulting forces will provide a direction for good governance.

Development of the US Securities Market suggests that securities markets in America developed to a remarkable degree during the 19th century. While the origin of the New York Stock Exchange (NYSE) dates back to 1792, it was not until after the Civil War that the market grew significantly, with rail roads constituting a significant portion of the
early listings. By 1880 trading volume reached sufficient levels when a continuous auction market system was instituted, and securities of the growing industrial sector began to be listed.

The NYSE Rules required annual financial reports, and encouraged quarterly reports as well, all before adoption of the securities laws. Offering disclosures of new issues were roughly similar to the current S-1, S-2 and S-3 registration statement standards although they lacked the overlay of trivial detail that the SEC has since mandated. Even at this early date the NYSE was competing on a 'quality margin,' as evidenced by the fact that its best practices in the prospectus area were used as the basis for the mandatory regulation that followed. Even so if these markets had been left unregulated, we would have expected competition on quality margins to have continued, and these standards would have embraced thousands of new issuers who sought public capital over the decades.

The accounting standards that are employed today have been left largely in the hands of the private sector, with only minimal interference from the SEC. With the onset of regulation, these essentially private standards were mandated and refined through SEC regulation to provide for the most detailed disclosure and financial reporting requirements in the world. If they are to be faulted, it is because too much, rather than too little, information is required to be disclosed.

The US capital markets raise in excess of $1 trillion per year, which has been estimated to be more than the combined total of all other capital markets. In 1980, the market capitalization of the New York Stock Exchange exceeded the combined capitalization of the exchanges in Tokyo, London, Montreal, Frankfurt, Toronto and Paris. While American markets are less dominant today, this comparison demonstrates the lead that the US had in the development of efficient capital market for many decades.
In short, the US Capital Market is an efficient capital market. Liquidity in these markets is relatively high, even for smaller companies, compared to liquidity and transparency that attracted large foreign investors to the US markets.

**U.K.**

Corporate governance system in UK is also based on individualism, competition, short-termism and a belief in market-oriented capitalism. The key players in this model are the institutional investors, particularly the big insurance companies and pension funds. Until recently, these owners of British industry have played merely a passive role in the companies they own.

This passive role started to change in the late 1980s when the extent of merger and acquisition activity removed executive management further from any effective shareholder control. This undermined further any conception of shareholder democracy that still existed, alienating shareholders from the decision-making process. This, along with management buy-outs, leveraged buy-outs and general capital restructuring, has obliged institutional investors to play a more active role in their involvement in corporate matters. Indeed, institutional shareholders are increasingly seen as having the capacity to decide whether power remains with executive management. Stratford Sherman sees power slowly shifting back to shareholders again. Hence, there is clearly a new willingness in institutional investors to influence actively the management of the companies they own. This has shown itself in investment protection committees and institutional shareholder committees, which have also helped to increase shareholder protection.

In the UK over 2,000 companies are quoted on the stock exchange out of a total population of around 5,00,000 firms. Almost 80% of the largest 700 companies are quoted on the stock exchange, and the value of companies quoted on the stock exchange
Germany has 171 large quoted companies dominated by different groups of investors—banks, investment institutions, companies, government, etc. Though the bank holdings aggregate only 5.8 per cent yet their role in controlling the corporate activities is significant than compared to the control exercised by the direct equity holders. The ownership indicators of new firms reveal that investments have been generally made in quoted companies and other corporate owners are generally not treated as partners, banks

In most of continental Europe, however, ownership is much more concentrated. The takeover market in UK is very active. During the merger waves at the beginning of the Seventies and the end of the eighties, as much as 4% of the total UK capital stock was acquired by takeover or merger in one year. Furthermore, it has been estimated that about 25% of takeover in the 1980s were ‘hostile’.

**Germany**

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...
and insurance companies often have substantial interests. Institutional investors play a vital role in corporate decision making. German system of corporate governance, therefore, can be described as insider system.

German capital market developed into efficient security market primarily because of the role played by the big German banks. German banks retarded the development of the security markets by exercising control over corporate proxy machinery. Further, German banks held shares of their clients in their own name and held them for saving tax. Whenever a shareholder wishes to sell his share he prefers to sell to another customer of same bank as it would be treated as intra bank transactions and will not result into a taxable affair. The transaction cost being high, gave further boost to such transactions.

Barriers to entry to capital markets were first created in 1884 when the German law restricted corporate access to the stock exchanges. This was accomplished by increasing the minimum size of a public offering and length of time a company had to be in existence before it could list its shares on an exchange. Such restrictions on listing, by forcing smaller companies to deal with the banks, ensured that debt would become the dominant form of financing in Germany and not equity, as in the United States.

At the same time, the big banks which are both the relevant markets as well as underwriters, appear to use their market power over secondary trading activity to dominate the primary markets for new issues and the underwriting process in most instances. The banks are said to underprice new issues to assure 'success', and also charge relatively high underwriting fees. And their combined positions as major stock holders, creditors, and underwriters provided them with an opportunity for insider trading, which was not legally prohibited until 1994.

Disclosure standards in Germany are also not upto US standards. German accounting system appears to provide far less information than US system. A wide variety of accounting methods are available to German firms that make comparisons difficult if not impossible. German corporations can freely create reserves that can be used to mask
earnings dips in bad years. It is hard to believe that accounting standards that permit huge reserves to be declared as current profits at management's discretion can provide the same transparency as GAAP reporting.

German stock markets remain relatively small and illiquid compared to American markets. Only about 2,800 German corporations are stock corporations (AGs), while the vast majority, approximately 2,20,000 are limited liability companies without tradable shares (GmbHs). Only a small number of firms, approximately 650, have shares traded on the exchanges. Even many of those companies are not actively traded, and they have floats that are less than one-half of their outstanding shares. Only 100 firms are widely held.

As a result of big bank dominance and weak capital markets, the frequency with which German companies resort to public capital markets is much lower than in the US. German corporations are forced to borrow from banks to a far greater extent than their American counterparts, with two obvious consequences: First, debt-equity ratios in Germany are much higher than in the United States. Second, it has been suggested that banks have charged German corporations excessive rates for borrowing thus restricting the growth of German industry. These characteristics hardly describe a mature and developed capital market by US standards. Finally, no market for corporate control exists in Germany to cure even the most extreme monitoring problems.

German system of corporate governance is based on two-tier management structure, comprising the Vorstand or management board, which is entrusted with the day-to-day running of the company, and the Aufrichtsrat or supervisory board, whose job is to supervise the management board, when necessary and to participate in long-term strategic decisions. This helps to prevent the abuses of management dominated boards in the unitary board system of the Anglo-Saxon model. On the supervisory board there are both shareholder and employee representatives, controlling the managing board, increasing accountability to a greater range of stakeholders, reducing institutional pressures upon
board of directors towards short-term decisions, and allowing for longer-term strategic planning.

This system of corporate governance has the longer-term interests of the company at heart. The longer-term interests of the company are demonstrated in greater investment in plant, equipment and intangible assets. As a result, less emphasis is placed on share dividend. This low return on shareholdings is not seen as a problem by the major shareholders in German industry, the banks, which have other business relationships with the companies they invest in. Apart from their shareholdings, German banks are also creditors and help debt-finance industry. However, this acceptance of a low return on the stock market may be about to change with the rising influence of the international institutional investor.

In conclusion while the German corporate governance system with its supervisory board, with both shareholder and employee representatives on it, is in many ways a superior governance system to that in the Anglo-Saxon model, but it has some inherent problems. Such a system ignores the interests of small shareholders, is over-secretative, and is ill-designed to cope with the pressures of international investment or the global market for companies. The biggest influence will be international force; in other words, the shaping of corporate governance by the globalisation of the financial and corporate markets. Despite these problems, which are solvable, the advantages of the German system of corporate governance, like that of the Japanese system, can be seen in its use of industrial groupings, implicit contracting and extensive cross shareholding, which are all relationship-oriented, and finally in the financial sector's close links with industry.

Two-tier board

(a) Supervisory board-supervises management board
    Representatives of shareholders
    Representatives of employees
    Paradox: wider accountability releases short-term pressures and allows more strategic thinking
There are many signs that elements of the German system will change over the coming years. As Germany struggles under a severe recession (exacerbated by the costs of integrating East Germany into the republic), there is increasing criticism of Germany's closed-door system of management, and an ever more urgent need to look beyond Germany for new capital. These forces are likely to have a far reaching effect on German corporate governance:

(b) Management Board – runs company
(c) Longer-term orientation
(d) Stable investment
   Plant
   Equipment
   Training
(e) Lower return to shareholders
(f) Close relationships to banks (80 percent of votes)
(g) Low reliance on capital markets
(h) Shareholders activism or hostile takeovers rare

Briefly speaking Germany lags behind the United States and the United Kingdom in terms of corporate disclosure; the following matters will be or are being addressed by regulatory or legislative action:
   accounting standards will be tightened;
   insider dealing is being made a criminal offence;
   restrictive voting structure will be dismantled;
   proper takeover legislation will be introduced, in particular extending the requirement to report holdings in other companies.

The cumulative effect of these changes will be to weaken the board's influence and increase the power of the institutional investors.

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German banks are reconsidering their stakes in German companies.

German and foreign shareholders are challenging the German practice of voting rights restrictions.

Generally lenient financial disclosure requirements in Germany may be about to change. In order to bolster Frankfurt as an international financial centre, for example, the German federal government proposed legislation ... debated in the Bundestag in the autumn of 1992. Included in the 'finanzplatz Deutschland' package is a proposal for a new federal supervisory agency for the securities industry and proposed legislation outlawing insider trading.

German institutions are likely to improve their standards of financial disclosure.

**Japan**

The system of corporate governance in Japan is perhaps the most remote and exotic of any of the developed world. This is primarily because this system heavily relies on trust and relationship oriented approach to corporate governance. Japanese corporations conduct their business without building defences and that is why they concentrate on the long-term interests of the company and invest in research and development, capital, employee training and skills development. While the hostile takeovers are unusual, particularly foreign ones, whereas mergers are more common. They tend to be with business in the same industry and often within the same group. This is particularly likely to occur if a group member is in financial difficulties, resulting in a merger with another company in the group. However, recently Japanese companies have started diversifying into unrelated areas often resulting into conflicts of interest between different stakeholders. Another important feature of Japanese corporate governance is the reliance on cross-shareholdings. Nearly 200 trillion yen of stock is held under reciprocal shareholding agreements. The governance shows that influence of such a mechanism is decreasing and the corporate governance in Japan is in transition. The growing competition in the capital market is also likely to change the Japanese corporate governance and the big institutions have started realising their obligations to maximise
shareholders value. Thus long-term institutional shareholdings and cross shareholdings of shares by several group of companies, which used to guarantee the management of reliable based control of a company, may no longer be as reliable as before. It is worth noting that now corporate governance issues have become conspicuous in Japan which is becoming fully integrated with the international financial world and the country has to learn to adopt both social and regulatory system. How it handles these changes and improves the aspirations of the investing communities will be a matter of interest and importance for the international investing community.

The salient features of the corporate governance in Japan are:

(a) Heavy reliance on trust and implicit contracting
(b) Relationship-oriented approach
(c) Close ties to banks
(d) Web of cross-shareholdings (200 trillion yen)
(e) Long-term investment orientation
   Research and development
   Capital investment
   Employee skills
(f) Many stakeholders – long-term interests
(g) Transition
   Mergers
   Speculations
   Recession

It is worth noting that the excesses of 1980 and financial scams which were witnessed in the political system, several amendments were made in the Japanese Commercial Code permitting shareholders to have an access to the company books. Shareholders have also been given right for filing suits. These changes have been introduced in October, 1993. From a corporate governance perspective, these developments are likely to have profound effects in the corporate behaviour. The supremacy of role of internal auditors in Japan has also been questioned, particularly after noticing the disbursement of large sums of money to politicians and bureaucrats. The recent research studies on the working of the corporates have also revealed that there is an external pressure on managements to
enhance financial returns to shareholders. Further, the slow down in the economy is compelling the Japanese corporations to raise money from international players and this is likely to bring about change in the rules of the corporate governance.
In the preparation of this Report, several earlier contributions on the subject both in India and worldwide were referred to. Following is a select listing of some of these documents.

**Codes & Guidelines**

Report of the Kumar Mangalam Birla Committee on Corporate Governance, (2000),
Securities and Exchange Board of India


Where Were the Directors? Guidelines for Improved Corporate Governance in Canada, (1994), Toronto Stock Exchange

Report on Corporate Governance, Five Years to the Dey, , (1999), Toronto Stock Exchange


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Internal Control -- Integrated Framework, (1992), The Committee of Sponsoring Organisations of the Treadway Commission

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Recommendations of the Committee on Corporate Governance, (Vienot II Report), (1999), Association Francaise des Entreprises Privees and Mouvement des Entreprises de France

Principles for Corporate Governance in the Commonwealth, Final version, (1999), Commonwealth Association for Corporate Governance
Books & Other Material

4. 21st Century Corporate Board, Ralph D Ward, (1997), John Wiley
5. Comparative Corporate Governance, (eds.) Klaus J Hopt and Eddy Wymeersch, (1997), Walter de Gruyter
9. Publications of the Institute of Company Secretaries of India, New Delhi including its monthly journal ‘Chartered Secretary’ and seminar, conference papers