CORPORATE GONERNANCE, ETHICS

&

SOCIAL RESPONSIBILITY OF BUSINESS

UNIT-II

EVOLUTION OF CORPORATE GOVERNANCE

The concept of good governance is very old in India dating back to third century B.C. where Chanakya (Vazir of Parliputra) elaborated fourfold duties of a king viz. Raksha, Vriddhi, Palana and Yogakshema. Substituting the king of the State with the Company CEO or Board of Directors the principles of Corporate Governance refer to protecting shareholders wealth (Raksha), enhancing the wealth by proper utilization of assets (Vriddhi), maintenance of wealth through profitable ventures (Palana) and above all safeguarding the interests of the shareholders (Yogakshema or safeguard). Corporate Governance was not in agenda of Indian Companies until early 1990s and no one would find much reference to this subject in book of law till then. In India, weakness in the system such as undesirable stock market practices, boards of directors without adequate fiduciary responsibilities, poor disclosure practices, lack of transparency and chronic capitalism were all crying for reforms and improved governance. The fiscal crisis of 1991 and resulting need to approach the IMF induced the Government to adopt reformative actions for economic stabilization through liberalization. The momentum gathered albeit slowly once the economy was pushed open and the liberalization process got initiated in early 1990s. As a part of liberalization process, in 1999 the Government amended the Companies Act, 1956. Further amendments have followed subsequently in the year 2000, 2002 and 2003.The major corporate governance initiatives launched in India since the mid-1990s.There are various reforms which were channelled through a number of different paths with both the Security and Exchange Board of India (SEBI)and the Ministry of Corporate Affairs, Government of India (MCA) playing important roles.

I. Evolution of Legal Framework of Corporate Governance in India

1. **Prior to Independence and Four Decades into Independence**

Indian associations/corporate entities were bound by colonial guidelines and a large portion of the principles and guidelines took into account the impulses and likes of the British employers. The Companies Act was enacted in 1866 and was amended in 1882, 1913 and 1932. Partnership Act was enacted in 1932. These enactments had a managing organisation model as a focus as people/business firms went into a legitimate contract with business entities to manage the latter. This period was an era of misuse/abuse of resources and shunning of obligations by managing specialists because of scattered and unprofessional proprietorship.

Soon after independence, there was interest among industrialists for production of a lot of essential items for which the Government directed and dictated fair prices. This was the point at which the Tariff Commission and the Bureau of Industrial Costs and Prices were set up by

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the Government. Industries (Development and Regulation) Act and Companies Act were introduced into the legal system in 1950s. 1960s was a time of setting up of heavy industries in addition to the routine affairs. The period between 1970s to mid-1980s was a time of cost, volume and profit examination, as a vital piece of the cost accounting activities.

2. **Coming of Age**

India has been distinctly looked upon by the associations/organisations worldwide with the objective of making inroads into untapped new markets. Dynamic firms in India made an endeavour to put the frameworks of good corporate administration in place from the word go, whether or not any regulations were in place. However, the scenario was not too encouraging, being too promoter-centric and good governance norms given a go by for the sake of convenience or comfort of the promoters.

Realising the need for governing the corporates more effectively and professionally to make them globally competitive, there have been a number of discourses and occasions prompting the advancement of corporate governance. The fundamental code for corporate administration was proposed by the Chamber of Indian Industries (CII) in 1998. The definition proposed by CII was—corporate governance manages laws, methods, practices and understood principles that decide an organisation's capacity to take administrative choices—specifically its investors, banks, clients, the State and the representatives.

II. Reformation in Corporate Governance

1. **The First Phase of India's Corporate Governance Reforms: 1996-2008**

The primary or the first phase of India's corporate governance reforms were focussed at making Audit Committees and Boards more independent, focussed and powerful supervisor of management and also of aiding shareholders, including institutional and foreign shareholders/investors, in supervising management. These reform efforts were channelled through a number of different paths with both the Ministry of Corporate Affairs (MCA) and the Securities and Exchange Board of India (SEBI) playing important roles.

(a) CII—1996

In 1996, CII taking up the first institutional initiative in the Indian industry took a special step on corporate governance. The aim was to promote and develop a code for companies, be in the public sectors or private sectors, financial institutions or banks, all the corporate entities. The steps taken by CII addressed public concerns regarding the security of the interest and concern of investors, especially the small investors; the promotion and encouragement of transparency within industry and business, the necessity to proceed towards international standards of disclosure of information by corporate bodies, and through all of this to build a high level of people's confidence in business and industry. The final draft of this Code was introduced in April 1998.

(b) Report of the Committee (Kumar Mangalam Birla) on Corporate Governance

Noted industrialist, Mr Kumar Mangalam Birla was appointed by SEBI—as Chairman to provide a comprehensive vista of the concern related to insider trading to secure the rights of

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several investors. The suggestions insisted on the listed companies for initial and continuing disclosures in a phased manner within specified dates, through the listing agreement. The companies were made to disclose separately in their annual reports, a report on corporate governance delineating the steps they have taken to comply with the recommendations of the Committee. The objective was to enable the shareholders to know, where the companies, in which they have invested, stand with respect to specific initiatives taken to ensure robust corporate governance.

(c) Clause 49

The Committee also realised the importance of auditing body and made many specific suggestions related to the constitution and function of Board Audit Committees. At that time, SEBI reviewed its listing contract to include the recommendations. These rules and regulations were listed in Clause 49, a new section of the listing agreement which came into force in phases of 2000 and 2003.

(d) Report of the Advisory Group on Corporate Governance: Standing Committee on International Financial Standards and Code—March 2001

The advisory group tried to compare the potion of corporate governance in India vis-à-vis the international best standards and advised to improve corporate governance standards in India.

(e) Report of the Consultative Group of Directors of Banks—April 2001

The corporate governance of directors of banks and financial institutions was constituted by Reserve Bank to review the supervisory role of boards of banks and financial institutions and to get feedback on the activities of the boards vis-à-vis compliance, transparency, disclosures, audit committees, etc. and provide suggestions for making the role of Board of Directors more effective with a perspective to mitigate or reduce the risks.

(f) Report of the Committee (Naresh Chandra) on Corporate Audit and Governance Committee—December 2002

The Committee took the charge of the task to analyse, and suggest changes in different areas like—the statutory auditor and company relationship, procedure for appointment of Auditors and determination of audit fee, restrictions if required on non-auditory fee, measures to ensure that management and companies put forth a true and fair statement of financial affairs of the company.

(g) SEBI Report on Corporate Governance (N.R. Narayan Murthy)—February 2003

So as to improve the governance standards, SEBI constituted a committee to study the role of independent directors, related parties, risk management, directorship and director compensation, codes of conduct and financial disclosures.

(h) (Naresh Chandra Committee II) Report of the Committee on Regulation of Private Companies and Partnerships

As large number of private sector companies were coming into the picture there was a need to revisit the law again. In order to build upon this framework, the Government constituted a

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committee in January 2003, to ensure a scientific and rational regulatory environment. The main focus of this report was on (a) the Companies Act, 1956; and (b) the Partnership Act, 1932. The final report was submitted on 23-7-2003.

(i) Clause 49 Amendment—Murthy Committee

In 2004, SEBI further brought about changes in Clause 49 in accordance with the Murthy Committee's recommendations. However, implementation of these changes was postponed till 1-1-2006 because of lack of preparedness and industry resistance to accept such wide-ranging reforms. While there were many changes to Clause 49 as a result of the Murthy Report, governance requirements with respect to corporate boards, audit committees, shareholder disclosure, and CEO/CFO certification of internal controls constituted the largest transformation of the governance and disclosure standards of Indian companies.

2. **Second Stage of Corporate Governance—After Satyam Scam**

India's corporate community experienced a significant shock in January 2009 with damaging revelations about board failure and colossal fraud in the financials of Satyam. The Satyam scandal also served as a catalyst for the Indian Government to rethink the corporate governance, disclosure, accountability and enforcement mechanisms in place. Industry response shortly after news of the scandal broke, the CII began examining the corporate governance issues arising out of the Satyam scandal. Other industry groups also formed corporate governance and Ethics Committees to study the impact and lessons of the scandal. In late 2009, a CII task force put forth corporate governance reform recommendations.

In its report the CII emphasised the unique nature of the Satyam scandal, noting that—Satyam is a one-off incident. The overwhelming majority of corporate India is well run, well regulated and does business in a sound and legal manner. In addition to the CII, the National Association of Software and Services Companies (Nasscom, self-described as—the premier trade body and the Chamber of Commerce of the IT-BPO industries in India) also formed a Corporate Governance and Ethics Committee, chaired by N.R. Narayana Murthy, one of the founders of Infosys and a leading figure in Indian corporate governance reforms. The Committee issued its recommendations in mid-2010.

III. Legal Framework on Corporate Governance

1. ***The Companies Act, 2013.***— consists of law provisions concerning the constitution of the board, board processes, board meetings, independent directors, audit committees, general meetings, party transactions, disclosure requirements in the financial statements and etc.

2. ***SEBI Guidelines.***—SEBI is a governing authority having jurisdiction and power over listed companies and which issues regulations, rules and guidelines to companies to ensure the protection of investors.

3. ***Standard Listing Agreement of Stock Exchanges.***—is for those companies whose shares are listed on the stock exchanges.

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4. ***Accounting Standards Issued by the Institute of Chartered Accountants of India (ICAI).***— ICAI is an independent body, which issues accounting standards providing guidelines for disclosures of financial information. In the new Companies Act, 2013 Section 129 provides that the financial statements would give a fair view of the state of affairs of the companies, following the accounting standards given under Section 133 of the Companies Act, 2013. It is further given that the things contained in such financial statements should be in compliance with the accounting standards.

5. ***Secretarial Standards issued by the Institute of Company Secretaries of India (ICSI).***—ICSI is an independent body, which has secretarial standards in terms of the provisions of the new Companies Act. ICSI has issued secretarial standards on "Meetings of the Board of Directors" (SS-1) and secretarial standards on "General Meetings" (SS-2). Given secretarial standards have come into force from 1-7-2015. Companies Act, 2013, Section 118(10) provides that every company (other than one person company) shall observe secretarial standards specified as such by the ICSI with respect to general and Board meetings.

SEBI GUIDELINES AND CLAUSE 49

Clause 49 of "Listing agreement" deals with the complete guidelines for corporate governance. Following are the provisions, a company, must comply to implement effective corporate governance.

Corporate Governance-: In order to comply with clause 49(1) a company must adhere with some following principles.

1. **Right of Shareholder-** As shareholders are the ultimate owner of the company, the company should seek to protect and facilitate the exercise of right of shareholders. A company must always be transparent with its shareholders and shareholders should have all the rights regarding General Meeting such as information about meeting, participate, Vote and questioning in GM etc.
2. **Role of stakeholders-** A company must take care of stakeholder's right and encourage cooperation between company & stakeholders. Their rights can be by Mutual agreement or by Applicable law or statute.
3. **Disclosure & Transparency-** It is the obligation on company to be transparent with its stakeholders by giving disclosures of all material matters on timely basis. Disclosure can be regarding financial position, Performance, ownership and Governance etc. Non-disclosure of Material Matter is Strictly Prohibited.
4. **Responsibility of Board-** Members of the Board should disclose their interest in company and in any individual transaction and contract. They should also maintain the rule of confidentiality. They should also perform their key function such as preparation of major action plan, corporate Strategy, execution of Board, and effective financial Performance.

The Securities Exchange Board of India (SEBI) added Clause 49 to the Listing Agreement in 2000. The clause was enacted with the aim of improving corporate governance of all

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companies listed on the Indian stock exchanges including the NSE and BSE. Clause 49 was revised in 2004 to bring it more in line with the Sarbanes-Oxley Act enacted by the United States government.

Background:

Clause 49 was added to the Listing Agreement on the recommendations of the Kumara Mangalam Birla Committee on Corporate Governance instituted by SEBI. The clause initially recommended basic corporate governance practice for Indian companies and made key changes in the areas of governance and disclosures. It made the following requirements mandatory:

- Minimum number of Independent Directors on their boards
- Institution of Audit, Shareholders' Grievance Committees and so on
- Annual reports to include Management' Discussion and Analysis (MD&A) section and Corporate Governance report
- Fees paid to non-executive directors to be disclosed
- Limited the number of committees on which a director could serve

2004 Amendments to Clause 49 by the Narayana Murthy Committee

To further strengthen the clause and make it more in line with the Sarbanes Oxley Act implemented in the United States following a series of corporate governance failures, SEBI constituted the Narayana Murthy Committee to review the clause and its effectiveness. The committee was also tasked with formulating improvements to the clause. Clause 49 was amended by SEBI to include the following changes as suggested by the committee on October 29, 2004 and came into effect in January 2006:

- Major changes and clarifications in the definition of Independent Directors
- Responsibilities of audit committees strengthened
- Financial disclosures to be more comprehensive and include those relating to party transactions and proceeds from public/rights/preferential issues
- Boards to adopt formal codes of conduct
- CEO/CFO to certify financial statements
- Disclosures to shareholders to include more comprehensive information

Among the non-mandatory clauses are a whistle-blowers policy and restriction of terms of independent directors.

Further amendments

SEBI further amended Clause 49 in 2008 to extend the requirement for at least 50% of boards to include independent directors to all boards where the non-executive chairman is a promoter of the company or related to the promoters of the company.

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Highlights of Clause 49 and its sections:

Section and Sub-Section	**Description**
I. Board of Directors	(A) Composition of Board (B) Non executive directors' compensation and disclosures (C) Other provisions as to Board and Committees (D) Code of Conduct
II Audit Committee	(A) Qualified and Independent Audit Committee (B) Meeting of Audit Committee (C) Powers of Audit Committee (D) Role of Audit Committee (E) Review of information by Audit Committee
III. Subsidiary Companies	
IV. Disclosures	(A) Basis of related party transactions (B) Disclosure of Accounting Treatment (C) Board Disclosures – Risk management (D) Proceeds from public issues, rights issues, preferential issues etc. (E) Remuneration of Directors (F) Management (G) Shareholders
V. CEO/CFO certification	
VI. Report on Corporate Governance	
VII. Compliance	
Annexure I A	Information to be placed before Board of Directors
Annexure I B	Format of Quarterly Compliance Report on Corporate Governance
Annexure I C	Suggested List of Items to Be Included in the Report on Corporate Governance in the Annual Report of Companies

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Annexure I D	Non-Mandatory Requirements: (1) The Board (2) Remuneration Committee (3) Shareholder Rights (4) Audit qualifications (5) Training of Board Members (6) Mechanism for evaluating non-executive Board Members (7) Whistle Blower Policy

Provisions

Following are the highlights of Clause 49's provisions:

Company Board of Directors

The clause defines an Independent Directors as a non-executive director of the company who:

- Receives only director's remuneration and should have no other pecuniary relationships or transactions with the company or its promoters
- Is not related to promoters or management at the board level
- Has not been an executive of the company in the immediately preceding three financial years
- Has had no associations in three preceding years with audit firms, legal or consulting firms associated with the company
- Does not hold substantial shares in the company

The compensation paid to non-executive directors including independent directors will be fixed by the board and should have prior approval of shareholders.

The Board should meet at least four times a year, with a maximum time gap of three months between any two meetings.

A Board director should not be a member of more than 10 committees or act as Chairman of more than five committees across all companies of which he is a director.

Code of Conduct:

The board should lay down a code of conduct for all its members and senior management of the company. All the members and senior management personnel have to affirm compliance with the code every year. The annual report of the company should contain a declaration stating this signed by the CEO.

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Audit Committees

The audit committee should comprise:

- A minimum of three directors as members
- Two thirds of the members should be independent directors
- All members have to be financially literate
- At least one member should have accounting or related financial management expertise

The committee should meet at least four times in a year. The gap between each meeting should not exceed four months.

CEO/CFO Certification

The CEO/CFO should certify to the board that:

- They have reviewed financial statements and cash flow statements for the year
- The company has not entered into fraudulent or illegal transactions to the best of their knowledge and belief
- They accept responsibility for establishing, maintaining and evaluating internal controls
- They have informed the auditors and the audit committee about the significant changes to internal control and accounting policies as well as instances of fraud.

Subsidiary Companies

Regarding subsidiary companies, Clause 49 stipulates that:

- At least one independent director on the board of the holding company should be a director on the board of a material non listed Indian subsidiary company.
- The audit committee of the listed holding company should review the financial statements, in particular, the investments made by the unlisted subsidiary company.
- The management should present the board of the listed holding company a statement of all significant transactions and arrangements entered into by the unlisted subsidiary company.

Corporate Governance Report

According to Clause 49, annual reports of listed companies should contain a separate section on corporate governance. This section should contain:

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- A detailed compliance reports. Non-compliance of mandatory requirements of Clause 49 should be explained with reasons.
- The extent to which non-mandatory requirements have been adopted and implemented should be highlighted

Companies should submit quarterly compliance report to stock exchanges. These reports should be signed either by the compliance officer or CEO of the company.

COMPANIES ACT 2013

Despite of all the mandatory and non-mandatory requirements as per Clause 49, India was still not in a position to project itself having highest standards of corporate governance. Taking forward, the Companies Law 2013 also came up with a dedicated chapter on Corporate Governance. Under this law, various provisions were made under at least 11 heads viz. Composition of the Board, Woman Director, Independent Directors, Directors Training and Evaluation, Audit Committee, Nomination and Remuneration Committee, Subsidiary Companies, Internal Audit, SFIO, Risk Management Committee and Compliance to provide a rock-solid framework around Corporate Governance.

Summary of Major Provisions

The key provisions in Clause 49 and 2013 act are summarized as follows for quick overview:

ED,NED and ID

There are two kinds of directors in the companies' viz. Executive Directors (ED) and Non-executive Directors (NED). The Non-Executive Directors are divided into two categories viz. Independent Directors (ID) and others. Thus, every listed company has Executive Directors, Non-Executive Directors and Independent Directors on its board.

Rationale behind Independent Directors

The Independent directors are primarily meant to *oversee the functioning of the board and ensure that the decisions it makes do not hurt the interests of minority shareholders*. The current norms demand that the two third members of the Audit Committee and the Chairman should also be Independent.

An independent director can server in the same capacity in maximum seven companies. Further, if a person is whole-time director, he cannot be an independent director in more than three listed firms. An Independent Director who has already served on a company's board for 5 years can serve only one more term of 5 years. Companies are now required to disseminate Independent Director's resignation letter to Stock Exchanges & on company website.

Women Directors

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The Companies Act 2013 provides that every listed company has to appoint at least one-woman director. Appointment of women directors was hitherto voluntary but making it mandatory in Companies Act would draw have more talented woman on the boards of their companies.

Related Party Transactions (RPTs)

To enhance the transparency, there are rules regarding RPTs (Relative Party Transactions). These rules make sure that in all material dealings by company promoters, business decisions are not against the interests of small and minority shareholders.

Top Level remuneration

To check the tendency of fixing unreasonably high compensations for promoters and top-level executives, the new norms have mandatory constitution of a nomination and remuneration committee with an independent chairman. Moreover, all companies will need to follow enhanced disclosures norms on remuneration. These disclosure norms mandate the company to disclose the ratio of remuneration of top executives to median remuneration.

Audit Committee and whistle blower mechanism

There are rules and norms which expand the role of audit committee in listed firms and direct them to adopt a compulsory whistle blower mechanism to curb unfair business practices and protect the interest of minority stakeholders.

Concluding Remarks

After the Satyam Scandal, SEBI became more and more strict towards disclosure norms and implementation of Clause 49 provisions to bring about sea changes in transparency and accountability in the country. The Companies Act gave these norms a proper statutory backing. Towards transparency and accountability, there are laws regarding compulsory rotation of auditors and audit firms. An auditor cannot perform non-audit services for a company. Auditors are required to report fraudulent acts noticed during performance of their duties. Further, the act mandates that at least one third of board of a company has to consist of independent directors. Independent directors have been prohibited from receiving stock options or remuneration. To ensure greater transparency, additional disclosure norms such as formal evaluation of performance of the board of directors, filing returns with the registrar of companies with respect to any change in share holding positions of the promoters has been mode mandatory. Adoption of new accounting system may also help to check any fraud in accounting. Also, statutory status for Serious Fraud Investigation Office (SFIO) has been proposed. Investigation report of SFIO filed with court for framing charges shall be treated as report filed by police officer. With these steps in place, transparency and accountability of corporate governance in India stand at better position than before the Satyam Scandal.

Corporate Governance in Public Sector Units

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Introduction

Public enterprises in India are classified under three categories—

1. Departmental Undertaking,
2. Statutory corporations financed by Government
3. Government companies set up under the Companies Act, 2013 or Public-Sector undertakings.

Contribution of PSUs

PSUs have played an important role in the Indian economy since independence. They were created as vehicles for industrial and regional development, creation of basic infrastructure networks, and employment generation. PSUs continue to play an active role in the Indian economy. Their contribution to the economy can be judged from the fact that 320 PSUs (244 operating and 76 under construction PSUs) with a total investment of ` 11,71,844 crores earned a net profit of ` 1,15,767 crores in 2015-16. They have employed 12.34 lakh people and total Market Capitalization (M-Cap) of 46 PSUs, whose stocks are being traded, as per cent of BSE M-Cap was 11.68% during 2015-16. They contributed ` 2,78,075 crores to the central exchequer by way of dividends, taxes, etc. PSEs have done exemplary work for the upliftment of local communities by addressing their education and drinking water needs through CSR initiatives.

The Government of India (GOI) has taken a number of steps over the years to improve their performance including through better corporate governance. Table summarizes various Public-sector reforms in India since liberalization in 1991.

- Brief History of Public Sector Reforms in India since liberalization in 1991

Phase of the Reform	***Time Period***	***Key Reforms***
Phase 1: ***New Industrial Policy***	July 1991 – May 1996	υ "De-reservation" involving liberalization of hitherto closed sectors dominated by state monopolies υ "Disinvestment" involving limited and partial sale of government shares υ "Sick" PSUs referred to the board for industrial and financial reconstruction.

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Phase 2: *Empowerment of Public Sector Undertakings*	June 1996 – March 1998	υ Operational autonomy granted to very large PSU υ Professionalisation of the Board of Directors in every PSU υ Disinvestment commission set up. υ Dramatic reduction in state compliance guidelines and requirements.
Phase 3: *Open Privatization*	April 1998 – May 2004	υ Buy-back of shares allowed υ Downsizing, restructuring and professionalisation of PSUs and their Governing Boards υ Shutting-down selected sick PSUs.
Phase 4: *Better Governed PSUs envisaged*	May 2004 – present	υ Corporate guidelines for PSUs introduced.

Source: Adapted from World Bank Study entitled, *"Corporate Governance of Central Public-Sector Enterprises",* 2010.

Corporate Governance Framework

Provisions as contained in the Companies Act, 2013; SEBI guidelines on Corporate Governance; and DPE guidelines on Corporate Governance for Central Public-Sector Enterprises provide the Corporate Governance framework for listed PSUs in India. SEBI guidelines are not applicable to non-listed PSUs.

- Provisions as contained in the Companies Act, 2013

The Companies Act, 2013 was enacted on 29 August, 2013 and it replaced the Companies Act, 1956. The Ministry of Corporate Affairs has also notified Companies Rules, 2014 on Management and Administration, Appointment and Qualification of Directors, Meetings of Board and its Powers and Accounts. The Companies Act, 2013 together with the Companies Rules provide a robust framework for Corporate Governance all companies including PSUs registered under the Companies Act. Some of the important requirements which have been laid down are with regard to:

1. Qualifications for Independent Directors along with the duties and guidelines for professional conduct (Section 149(8) and Schedule IV thereof).

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2. Mandatory appointment of one-woman director on the board of listed companies [Section 149(1)].
3. Mandatory establishment of certain committees like Corporate Social Responsibility Committee [Section (135)], Audit Committee [Section 177(1)], Nomination and Remuneration Committee [Section 178(1)], and Stakeholders Relationship Committee [Section 178(5)].
4. Holding of a minimum of four meetings of Board of Directors every year in such a manner that not more than 120 days shall intervene between two consecutive meetings of the Board [Section 173(1)].

- SEBI Guidelines on Corporate Governance
  - Securities and Exchange Board of India (SEBI) is the capital market regulator in India. It amended Clause 49 of the Listing Agreement in 2014 in order to align it with the Corporate Governance provisions specified in the Companies Act, 2013.
  - It is applicable to all companies, including PSUs, which are listed on a recognized stock exchange. There are certain exceptions. Clause 49 has been discussed in Paragraph 18.3.
- DPE guidelines on Corporate Governance for Central Public-Sector Enterprises

1. The Department of Public Enterprises (DPE) issued first ever guidelines on Corporate Governance in November 1992 for PSUs which were voluntary in nature.
2. These have been revised from time to time, latest being the DPE guidelines in May, 2010.
3. These guidelines are mandatory and are applicable to all PSUs – listed or not listed.
4. The guidelines issued by DPE has covered areas like composition of Board of Directors, composition and functions of Board committees like Audit Committee, Remuneration committee, details on subsidiary companies, disclosures, reports and the schedules for implementation.
5. DPE has also incorporated Corporate Governance as a performance parameter in the MoUs of all PSUs.
6. In July 2014, DPE issued revised guidelines for grading the PSUs on Corporate Governance.
7. In order to encourage compliance with guidelines, DPE made it clear that deviation from Corporate Governance guidelines would attract negative marking in the performance evaluation of PSUs under Memorandum of Understanding process from the fiscal year 2015-16.

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- **Issues in Corporate Governance of PSUs**

Since the launch of New Industrial Policy, many Indian PSUs have grown immensely domestically as well as globally. To increase competitiveness and improve investor confidence, it is important for them to embrace corporate governance standards which would ensure further growth in an ethical and transparent manner. The major impediment in achieving desired level of competitiveness is governance deficit due to certain key issues which require immediate attention. Some of these are:

1. ***Autonomy of the Board*** **–** A competent and autonomous Board is important for success of any corporate. However, Ministerial diktats may, at times, influence the Board agenda in case of PSUs and take precedence over strategic and commercial considerations. PSUs have no role even in selection of independent directors. Without full operational and financial autonomy, it is difficult to have a structured performance evaluation system for the Board members and fix accountability.

2. ***Ownership policy*** – There is no ownership policy in place. It is needed to clearly lay down role and responsibilities of the Government towards minority shareholders and other stakeholders such as employees, vendors, customers and communities. The Organisation for Economic Cooperation and Development (OECD) states that "the government should develop and issue an ownership policy that defines the overall objectives of state ownership, the state's role in corporate governance of state-owned enterprises and how this policy is likely to be implemented." The ownership policy should be clearly disclosed and communicated to fix accountability.

3. ***Appointment of independent, non-executive directors and women directors on PSU boards*** – Legal provisions and Guidelines issued by SEBI and DPE have laid down requirements for the constitution of PSUs Board to ensure their independence and gender diversity. It is widely believed and empirically established that properly structured Board is necessary for ensuring objectivity of Board's decisions and exercising oversight over decisions of Board and its Committees. Out of the top 27 PSUs, according to a recent study[4], 25 per cent do not meet the criteria for independence of the Board and nearly 25% do not have a woman director.

4. ***Non-compliance with legal requirements and SEBI and DPE Guidelines*** **–** It is disconcerting to note that many of the top PSUs are falling behind in complying with minimum requirements envisaged in Clause 49 and DPE Guidelines. Even the compliance audit conducted by the Comptroller and Auditor General of India has highlighted this issue.

5. ***Excessive regulation*** **–** Besides Parliament, PSUs are also accountable to other authorities like Comptroller & Auditor General of India, (CAG); Central Vigilance Commission, (CVC); Competition Commission of India, (CCI); and

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Right to Information Act, (RTI) etc. Over regulation has not only created accountability problems but has also killed corporate governance.

Issue of Governance deficit in PSUs should be addressed and if the PSUs have to make a mark on world business map then they should be looked at not as Government but entities running to make judicious use of resources they have been entrusted with. It is interesting to note the observation of the force behind establishment of PSUs in India, Pt. Nehru, in this context. While debating on Second Five Year Plan in Parliament, he said, *"I have no doubt that the normal governmental procedure applied to a public enterprise will lead to the failure of that public enterprise. Therefore, we have to evolve a system for working public enterprises where on the one hand, there are adequate checks and protections, and on the other, enough freedom for that enterprise to work quickly and without delay."*

CORPORATE GOVERNANCE IN BANKING

"Corporate governance is the **acceptance by management of the inalienable rights of shareholders** as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It is about **commitment to values, about ethical business conduct and about making a distinction between personal and corporate funds** in the management of a company." Report of the Committee on Corporate Governance of the Securities and Exchange Board of India, 2003

In the last 20 years, corporate governance in the Banking sector has changed drastically. All over the world, many committees were set up to look into this aspect like the Cadbury Committee, OECD Code, Combined Code of London Stock Exchange, the Blue-Ribbon Committee and Kumar Mangalam Birla Committee in India.

The latest reason, which we all can remember due to which corporate governance in banking sector is being enhanced, is the **financial crisis of 2007-2008** during which Lehman Brothers went bankrupt and many other big names like Merrill Lynch, AIG, Freddie Mac, Fannie Mae, HBOS, Royal Bank of Scotland, Bradford & Bingley, Fortis, Hypo and Alliance & Leicester all came close to bankruptcy and were rescued by government intervention.

In the Indian context, **failure of cooperative banks and collapse of Yes bank, governance problems in ICICI and PSBs** have raised a major question on the effectiveness level of corporate governance being followed by the banks.

Why we need corporate governance for banks?

Corporate governance and economic development are inter- linked. Efficient corporate governance systems encourage the development of robust financial systems. Banks play a **crucial role in the flow of capital**. Banks are an imperative constituent of any economy. Hence, the proper governance of banks is very crucial for growth and development of the economy and the country as a whole. **Failure of one institution may have a cascading effect resulting in significant costs to the economy.** Fundamentally, banks must act in a way that **promotes "confidence" to its stakeholders**. Good corporate governance and supervisory actions harmonize one another.

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Basel Committee

Appreciating the diversity in structure of corporate governance mechanisms across the world, the Basel Committee in 1999, recommended **four important forms of oversight** that should be included in the organisational structure of any bank in order to ensure the appropriate checks and balances. They are

- **oversight by the board of directors or supervisory board;**
- **oversight by individuals not involved in the day-to-day running of the various business areas;**
- **direct line supervision of different business areas**
- **Independent risk management and audit functions.**

The committee also emphasizes on the importance of **key personnel being fit and proper** for their jobs.

Corporate governance and cooperative banks

Urban Cooperative Banks are a key sector in the Indian Banking Industry. In recent years, this sector has faced a lot of turmoil and turbulence, resulting in bankruptcy and closure of many cooperative banks. The cooperative movement started in India with the enactment of Cooperative Societies Act in 1904. In 1966, the Banking Regulation Act was made applicable to UCBs. To address the issue, **the RBI has been given more powers** have been given to the central bank.

In India, **SEBI, through the Clause 49 of the Listing Agreement**, requires all listed banks to adhere to corporate governance regulations officially. Cooperative Banks, however, are not listed as they do not trade in shares. This is the main difference between cooperative banks and other banks in the banking sector. But the RBI has been making continuous efforts to see that cooperative banks also maintain the highest standards of corporate governance. Most of the problems faced by the cooperative banks can be attributed to corporate governance issues.

Measures taken by banks towards implementation of best practices

Prudential norms in terms of income recognition, asset classification, and capital adequacy have been well assimilated by the Indian banking system. Also, norms governing provisioning requirements in respect of doubtful assets have been made more stringent in a phased manner.

Capital Adequacy: All the banks barring are required to comply with the minimum capital requirement

ALM and Risk Management Practices – Steps have been taken to address liquidity issues and manage risks of the banks, like the recently launched **liquidity framework and LCR, NSFR** requirements by the RBI. Risk management is done thr'

- **CAMELS and CALCS framework**

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- **PCA**
- **Basel norms**

Measures taken by regulator towards corporate governance

Reserve Bank of India has taken various steps furthering corporate governance in the Indian Banking System. These can broadly be classified into the following three categories:

1. **Transparency b) Off-site surveillance c) Prompt corrective action**

Transparency and disclosure standards are also important constituents of a sound corporate governance mechanism.

Recent paper by the RBI to overhaul corporate governance

- To build a robust culture of sound governance practice, professional management of banks and to adopt the principle of separating ownership from management, it is desirable to **limit the tenure of the WTDs (Whole Time Directors) or CEOs**
- It is felt that **10 years is an adequate time limit for a promoter / major shareholder** of a bank as WTD or CEO of the bank to stabilise its operations and to transition the managerial leadership to a professional management.
- Further, in the overall interest of good governance, **a management functionary who is not a promoter / major shareholder can be a WTD or CEO of a bank for 15 consecutive years.**
- **The board, through its NRC, is responsible for oversight of management's implementation of compensation system for the entire bank**. In addition, the board, through its NRC, shall regularly monitor and review outcomes to assess whether the bank-wide compensation system is creating desired incentives. The NRC shall **review the compensation plans, processes and outcomes at least annually**.

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