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IMPORTANCE OF CORPORATE GOVERNANCE IN A COMPANY IN INDIA

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Abstract: Corporate Governance is the new golden term coined in the corporate sector in the late 1990's by the Industry Association on Confederation of Indian Institute which was the first initiative in India as a voluntary measure to be adopted by Indian companies. It has outlined a series of voluntary recommendations to integrate best-in-class practices of corporate governance in listed companies which touches the four cornerstones of fairness, transparency, accountability and responsibility in managing the affairs of the company. Corporate Governance practices in the effective management of the company can be seen as introduction to new significant provisions introduced in the Companies Act, 2013 in form of independent directors, women directors on the board, corporate social responsibility and mandatory compliance of Secretarial Standards issued by Institute of Company Secretaries of India as per Section 118 of Companies Act, 2013.

Keywords: Corporate Governance, Companies Act 2013, Corporate Social Responsibilities, Board of Directors, Audit Committee, Internal Audit

1.0 Introduction

Corporate Governance is the new golden term coined in the corporate sector in the late 1990's by the Industry Association on Confederation of Indian Institute which was the first initiative in India as a voluntary measure to be adopted by Indian companies. It has outlined a series of voluntary recommendations to integrate best-in-class practices of corporate governance in listed companies which touches the four cornerstones of fairness, transparency, accountability and responsibility in managing the affairs of the company. The second major initiative was taken by Security Exchange of India (SEBI) as Clause 49 of the Listing Agreement. The third key initiative to effectively introduce Corporate Governance was taken by Naresh Chandra Committee and Narayana Murthy Committee who previewed Corporate Governance model working in companies from the viewpoint of shareholders, investors and other stakeholders of the company. Corporate governance guidelines both mandated and voluntary have evolved since 1998, due to the sincere efforts of several committees appointed by the Ministry of Corporate Affairs (MCA) and the SEBI. The real change in the corporate sector could be felt with the introduction of 2009 Mandatory Corporate Governance Voluntary Guidelines which has to be comply by companies listed on stock exchange by Clause 49 of Listing Agreement including mandatory codes to be followed by companies pertaining to board of directors, audit committees and various disclosures with respect to related party transactions, whistle blower policies etc. The final assent to Corporate Governance practices in the effective management of the company can be seen as introduction to new significant provisions introduced in the Companies Act, 2013 in form of independent directors, women directors on the board, corporate social responsibility and mandatory compliance of Secretarial Standards issued by Institute of Company Secretaries of India as per Section 118 of Companies Act, 2013.

2.0 Meaning

Corporate governance is the system of rules, practices, and processes by which a firm is directed and controlled. Corporate governance essentially involves balancing the interests of a company's many stakeholders, such as shareholders, senior management executives, customers, suppliers, financiers, the government, and the community.
Since corporate governance provides the framework for attaining a company's objectives, it encompasses practically every sphere of management, from action plans and internal controls to performance measurement and corporate disclosure.

3.0 Need for Corporate governance in India

The collapse of international giants like Eronf, Worlcom, Tyco, AOL and financial scams like Satyam have been big eye-openers in the corporate arena to make realise the company's management, ownership and stakeholders the emergent need to comply with Corporate Governance principles in order to prevent themselves from paying huge corporate criminal liabilities in the future. These huge corporate giants paid the cost for lack of good corporate

governance practices and corrupt policies adopted by management of these companies and their financial consulting firms.

The significance of good corporate governance solutions has widened because of the increasing conflict between ownership and management disciplines, the non-compliance of financial reporting by auditors which inflicts heavy losses on investors and lack of fair and transparent culture in the company which shook's investor trust in the financial viability of the company and its ethical standards.

The need for corporate governance has emerged because of the increasing concerns about the non-compliance of standards of financial reporting and accountability by boards of directors and management of companies causing heavy losses to investors. Following are the needs for corporate governance in India:

3.1 Changing Ownership Structure: A corporate firm has lots of stakeholders with different attitudes towards corporate affairs, corporate governance protects the stakeholders' right by implementing it through its code of conduct. Today a company has a very large number of stakeholders spread all over the nation and even the world and a majority of shareholders act unorganised with an indifferent attitude towards corporate affairs. Maintaining a proper structure of a corporate body requires a practical implementation of rules and regulations through a code of conduct of corporate governance.

3.2 Social responsibility: Society having greater expectations from corporate, they expect that corporates take care of the environment, pollution, quality of goods and services, sustainable development etc. Fulfilment of all these expectations is only possible with proper corporate governance.

3.3 Takeovers and Mergers: Takeovers and mergers of corporate entities created lots of problems in the past. It affects the right of various stakeholders in the company and creates a problem of chaos, this factor also pushes the need of corporate governance in the country.

3.4 Confidence booster: Corporate scams or frauds in the recent years of the past have shaken public confidence in corporate management. The need for corporate governance is then crucial for reviving investors' confidence in the corporate sector towards the economic development of society.

3.5 Mismanagement and corruption: It have been observed in both developing and developed economies that there has been a great increase in the monetary payments and packages of top-level corporate executives. There is no justification for exorbitant payments to top ranking managers, out of corporate funds which is a property of shareholders and society. This factor necessitates corporate governance to restrict the ill-practices of top managements in the companies.

3.6 Investors' influence: Large corporate investors are becoming a challenge to the management of the company as they influence the decisions of the company. Corporate governance set the code to deal with such situations.

3.7 Globalization: Globalization made the communication and transport between countries so easy and frequent. Many Indian companies are listed with international stock exchange which also triggers the need for corporate governance in India to structure the companies at par with international level.

3.8 Efficiency of management: Hostile takeovers of corporations witnessed in several countries put a question mark on the efficiency of managements of take-over companies. Lack of efficient code of conduct for corporate managements points out to the need for corporate governance.

4.0 Importance of Corporate Governance in India

Corporate governance safeguards not only the management but also the interests of stakeholders and fosters the economic progress of India in the roaring economies of the world. A company that has good corporate governance experiences much higher level of confidence amongst the shareholders associated with that company. Confident and independent directors contribute towards a positive outlook of the company in financial market which positively influences the share prices. Corporate Governance is one of the important criteria for foreign institutional investors to decide on which company to invest in.

- Good corporate governance creates transparent rules and controls, provides guidance to leadership, and aligns the interests of shareholders, directors, management, and employees.
- It helps build trust with investors, the community, and public officials.
- Corporate governance can provide investors and stakeholders with a clear idea of a company's direction and business integrity.
- It promotes long-term financial viability, opportunity, and returns.

- It can facilitate the raising of capital.
- Good corporate governance can translate to rising share prices.
- It can lessen the potential for financial loss, waste, risks, and corruption.
- It is a game plan for resilience and long-term success.

5.0 Principles of Corporate Governance

5.1 Transparency: The stakeholders should be informed about the company's activities, financial statements, and the organization's performance and also at the same time it is very important to give accurate and precise information to the shareholders. Poor transparency reduces the ability to raise more capital as the investors will be unaware of vital information. It also leads to less trust among the investors as a company that is financially stable and doing well will not have anything to hide. Moreover, companies that are doing well will like to make the financial statements public to promote themselves. Transparency in financial reporting increases the confidence of the shareholders will help them. The policies must be formulated in a manner which ensures transparency.
Transparency should also be maintained between directors and employees. The directors should be easily accessible by the employees and directors should be open to ideas of the management and employees. This makes employees more committed to the vision of the company. Lack of transparency will always lead to confusion and it will hinder the productivity of the management and employees.

5.2 Accountability : To achieve the goals and objectives of the company, people should be held accountable at all levels. Employees should be accountable to the management; management should be accountable to the board of directors and the board of directors should be accountable to investors and shareholders. Employees, management staff and directors will learn from the mistakes if they are made accountable and it leads to better utilization of the available resources. In this way the organization will grow faster as the scope for mistakes will be reduced considerably. It is the duty of directors to encourage accountability in the organization.

5.3 Responsibility : The directors of the company are primarily responsible to the shareholders, employees and the whole society. The directors of the company should work in the best interests of the company and its employees. It is the duty of the directors to determine the responsibility of the management and employees. Also, management and employees should be held accountable to make sure that responsibilities are carried out properly. Shareholders want directors to be responsible to their needs and maximize the value of the firm.

5.4 Fairness: Fairness principle not only enhances corporate value but it also leads to efficiency in resource allocation. All shareholders and investors should receive equal treatment by the company and the directors should try to prevent conflict of interests. It is very important to ensure fairness in transactions which are entered by the company. For e.g. a company should not enter into related party transactions without getting the approval of the shareholder. Effective communication mechanisms should be adopted by the company to make sure policies and financial statements are informed to the shareholders.

5.5 Shareholder Engagement: Shareholders should not be kept in the dark and must be informed of the financial position and organizational objectives. Minority and majority shareholders should be treated equally. All transactions must be avoided which might lead to conflicts with the shareholders.

5.6 Leadership: Board of directors is the brain of any company and it is under their leadership and guidance that any company expands and prospers. The directors should be committed to fulfilling the vision and mission of the company which is mentioned the constitution documents. Leadership also includes motivating the employees so that they reach the maximum potential. It also includes effective decision making and capitalize on opportunities to benefit the firm. Poor leadership by the board can create problems for the company and which may eventually end in bankruptcy or shutting down.

6.0 Corporate Governance under Companies Act, 2013

6.1 Board of Directors: Board of directors is the decision-making body of any company. It is the duty of the board to comply with all legal rules and regulations. So, it is very important that a company constitutes a board of directors as per the provisions of Companies Act, 2103.

6.2 Composition of Board: Section 149 of the Companies Act, 2013 provides for appointment of minimum three directors in a public company and two directors in a private company. A board can have a maximum of fifteen directors but can appoint more directors subject to special approval.

6.3 Women Director: It is mandatory to appoint a women director in the following classes of company: (i) Listed company (ii) Public unlisted company having paid-up share capital of one hundred crore rupees or more, or having a turnover of 300 crore or more.

6.4 Resident Director: Section 149(3) mandates that every company will have one director who has stayed in India for a period of not less than 182 days.

6.5 Independent Director: Independent directors are impartial and bring expertise to the board. They play an important role in resolving conflicts among shareholders and the company. Section 149(6) provides for the qualifications for appointing an independent director in a public company. As per Companies Act, 2013 public listed company shall have at least one-third of directors as independent directors and public unlisted company will have two directors if they meet the following criteria:

I. Public companies having a share capital of 10 crore or more;
II. Public companies having a turnover of 100 crore or more;
III. Public companies having outstanding loans, debentures and deposits of more than 50 crores.

According to section 134 of Companies Act, 2013 the director has to give a detailed financial report which includes the director's responsibility statement. This provision has been enacted to make directors accountable for their actions.

6.5.1 Stakeholder Relationship Committee

As per section 178(6) of Companies Act, 2013 if a company has more than one thousand shareholders, debenture-holders, deposit-holders or any other security holders in a financial year then it is mandatory to constitute a stakeholder relationship committee. The main of the committee is to resolve the conflicts between the shareholders and the board of directors and address their grievances. The chairperson of the board shall be a non-executive director.

6.5.2 Audit Committee:

The Audit Committee looks after the financial reports and disclosures of a company. It is one of the most important components of a corporate governance structure. Under section 177 of Companies Act, 2013 the following class of companies are required to constitute audit committee and they are as follows:

- Listed company
- Public company having a share capital of more than 10 crores;
- Public company having a turnover of Rs. 100 crores;
- Public companies having deposits, outstanding loans or debentures more than 50 crores.

An audit committee will consist of a minimum of 3 directors and independent directors will form the majority. Section 177(4) provides duties of the audit committee and it has to act in accordance with the same.

6.5.3 Internal Audit:

Companies Act, 2013 has mandated the internal audit for certain classes of companies as specified under Section 138 of the Companies Act, 2013.

7.0 Serious Fraud Investigation Offence (SFIO)

Section 211 (1) of the Companies Act, 2013 shall establish an office called the Serious Fraud Investigation office to investigate fraud relating to Company. The powers are given to SFIO under the act as mentioned that he can investigate into the affairs of the company or on receipt of report of Registrar or inspector or in the public interest or request from any Department of Central Government or State Government.

8.0 Nomination and Remuneration Committee

The nomination and remuneration committee decides the selection criteria for the key managerial personnel (KMP) and determines the remuneration of the KMP's and directors. Section 178 of Companies Act, 2013 mandates the constitution of committee for the following class of companies:

- Listed company;
- Public company having a share capital of more than Rs. 10 crores;
- Public company having a turnover of Rs. 100 crores;

- Public company having deposits, outstanding loans or debentures more than Rs.50 crores.

The nomination and remuneration committee will consist of a minimum of 3 directors and independent directors will form the majority.

9.0 Corporate Social Responsibility

The concept of CSR rests on the good corporate citizenship where corporate contributions to the societal growth as a part of their corporate responsibility for utilizing the resources of the society for their productive use.
Ministry of Corporate Affairs has recently notified Section 135 and Schedule VII of the Companies Act as well as the provisions of (CRS Rules) which has come into effect from 1 April 2014.

9.1 Applicability:

Section 135 of the Companies Act provides the threshold limit for applicability of the CSR to a Company:

- Net worth of the company to be Rs 500 crore or more;
- Turnover of the company to be Rs 1000 crore or more;
- Net profit of the company to be Rs 5 crore or more.

Further, as per the CSR Rules, the provisions of CSR are not only applicable to Indian companies but also applicable to branch offices of a foreign company in India.
CSR Committee and Policy
Every company as prescribed in Section 135 of the Act and Company (Corporate Responsibility) Rules, 2014 within the threshold limit requires spending of at least 2% of its average net profit for the immediately preceding 3 financial years on CSR activities.
Further, the company will be required to constitute a committee (CSR Committee) of the Board of Directors (Board) consisting of 3 or more directors.
The CSR Committee shall formulate and recommend to the Board, a policy which shall indicate the activities to be undertaken (CSR Policy); recommend the amount of expenditure to be incurred on the activities referred and monitor the CSR Policy of the company. The Board shall take into account the recommendations made by the CSR Committee and approve the CSR Policy of the company.
The new CSR regime is based on "Comply or explain" approach to stringently push big corporate giants to take initiative towards their duty to contribute towards their CSR activities. Companies failing to do so would be required to explain why they have not included such information, in the annual report as under Section 92 of the Companies Act, 2013 as part of "comply or explain" approach for large companies.

9.2 Related Party Transactions

A business transaction with relatives of Directors or KMP is considered as Related Party Transactions. It is very important to scrutinize transactions with related parties. Related party transactions are not banned in India and it can be entered by a company. There are certain conditions which need to be fulfilled before entering into a related party transaction as per Section 188 of Companies Act, 2013.

10.0 Class Action Suits

Class action suits allow a group of aggrieved people with the same grievance to file a collective suit against the company. It allows the minority shareholders to file a suit against the company and its management in the National Company Law tribunal (NCLT). Section 245 of Companies Act, 2013 allows suit to be initiated against its directors, management, auditors and any other person who is responsible for fraudulent, unlawful or wrongful act.

11.0 Conclusion

The Companies Act, 2013 empowers independent directors with proper checks and balances so that such extensive powers are not exercised in an unauthorized manner but in a rational and accountable way. The changes are a step forward in the right direction to smoothly run the management and affairs of the companies in the interest of stakeholders. These are all welcome changes in the globalised corporate world of today and they will strengthen the core corporate machinery by instilling strong corporate governance norms in a company leading to economic efficiency and higher ethical standards which will always inspire the company's management to work in the direction to uphold its goals of maximization of wealth of stakeholders backed with good corporate repute.

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