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CORPORATE GOVERNANCE AND ROLE OF DIRECTORS

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ABSTRACT

Corporate Governance has paved way to a new era of reforms in the performance of the Companies by ensuring transparency and accountability and thereby reducing Frauds. It has ensured a system of checks and balances, along with the setting of different review committees. This paper deals with the established principles of Corporate Governance and their specific impact on the Role of the Board of Directors and the other stakeholders. The history of Corporate Governance and the reason for its formulation. Also, keeping in pave with the amendments in the Company Law, Clause 49 of the Listing Agreement has remained the guarantor and the protector of Corporate Governance for the listed companies. The role of Independent Directors remains crucial for enhancing Corporate Governance in the company. Various other guidelines have been framed by SEBI, in this regard. Moreover, this paper also discusses the established by Organization for Economic Cooperation and Development (OECD).

***Keywords**:* Clause 49, Corporate Governance, Directors, Independent Directors, OECD

LITERATURE REVIEW

The Research Paper published by Springer brings out the importance of Corporate Governance in India and has highlighted the Role of Directors and their powers to deal with the general affairs of the company. Hence, the role and the performance of the Directors bring about the changes in transparency and the accountability in the Company.

OBJECTIVE

The objective is to understand the role played by directors to ensure the performance of the Company in a transparent manner and how the Company law and clause 49 of the listing agreement has enhanced the scope of Corporate Governance in India.

RESEARCH METHODOLOGY

The writer has used the secondary form of data in form of Books and internet resources to carry out the research. Also, the statute and the Bare Act was interpreted for this research.

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INTRODUCTION & HISTORY of CORPORATE GOVERNANCE

Corporate Governance principles are a formal set of guidelines that the Board of director's frame for internal governance of the Company which help in determining how the rights, liabilities and powers of various stakeholders. Corporate Governance is to a Company What Constitution is to a Country. It also determines the regulatory practices of the Company. Most importantly, Corporate Governance ensures fairness, accountability, ethics and transparency on the part of a company. Corporate Governance was made a necessity in 2002 in the U.S., following the collapse of major companies, due to accounting frauds and errors. This could have led to a second Great Depression of 1929. It was controlled through the Sarbanes Oxley Act; 2002 whose objective was to re-gain public confidence in the companies. This Act increased the accountability of the directors, mandated audit committees, increased the liability of the directors by making them personally responsible and by directing compulsory disclosures, etc. In the U.K., the setting up of the Cadbury Committee and adoption of their report in 1992 enhanced financial control and accountability.[1]

1.1. Evolution of Corporate Governance in India

The Satyam Scam involved accounting errors up to the amount of 7000 Crores which went undetected by the Company's auditors: Price Water Coopers. Deriving inspiration from the Sarbanes-Oxley Act, the Ministry of Corporate Affairs released voluntary guidelines on internal governance. These guidelines dealt with the independent directors, audit committees, separate office of the chairman and the CEO, along with other provisions relating to the tenure, remuneration of the directors. This was the work of the Naresh Chandra Committee. The SEBI added clause 49 to the listing agreement to ensure Corporate Governance on the part of the companies and has been revising it since. With the coming of the Companies Act of 2013, clause 49 has been made applicable to the private companies and the other body corporates as well in order to ensure that they do not violate their respective laws. Clause 49 came up with the work of Kumar Mangalam Birla Committee. The 2nd committee set by the SEBI was the Narayan Murthy Committee which mandated the requirement to adopt formal code of conducts and discussed stakeholder approval. The focus of the Corporate Governance has always been to coincide the interest of the shareholders /stakeholders and the Board of

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[1] Dr. C.L. Bansal, Corporate Governance, Taxmann's, 2005 Edn.

Directors who actually run the Company. The purpose of Corporate Governance is to achieve a responsible, value-oriented management and control of a corporation. This development in the sphere of Corporate Governance has led to an emergence of the basic principles namely:

- Accountability
- Transparency
- Equal treatment of all stakeholders/ Fairness
- Disclosures
- Trusteeship
- Empowerment
- Ethics

The Companies Act, 2013 has also mandated certain requirements in order to ensure Corporate Governance.

1.2. Role of Board of Directors

It is the board of directors who run the company on the behalf of the shareholders and are hence, the protector of the interest of different stakeholders. They form the link between the management and the shareholders of the company. It is their duty to implement the best policies by setting the goals and enhancing and enumerating measures to achieve them. [2]Therefore, it is necessary that the roles, powers and the skills required for a particular designation for the Board are exhaustively defined. Moreover, an independent Board would ensure lack of conflict of interest. The Board must be independent of the management and both must exist in separate spheres. The Board must conduct requisite meetings so that they are able to discharge their responsibilities in a transparent and answerable manner. The Board must answer its own performance and review the reports of the company.

The research paper deals with the provisions of Companies Act, 2013, the listing agreement and the OECD Guidelines that deals with the performance and the role of directors in enhancing proper corporate governance in their companies.

II. PROVISIONS IN THE COMPANY LAW

[2] Ibid

The Companies Act, 2013 also includes certain provisions that increase accountability and answerability of the Board or the directors. It also defines the roles and types of different directors. Following are some of the provisions:

2.1. Board's Report

As per Section 134(3), the Annual Report presented before the General Meeting should include the Board's report which consists of the following:[3]

- The Annual Return extract under Section 92.
- Number of Board's meetings
- **Directors' Responsibility Statement:** It deals with the mandate of the responsibility entrusted on the Board in laying down the internal controls, maintenance of accounting records and preparation of financial accounts. The board state that the requisite accounting standards have been prescribed with and if not, proper explanation have been given. They must state that the financial statements give a true picture of the organization and that the accounting policies are reasonable, prudent and consistently applied. Moreover, accounting records have been maintained properly, assets have been safeguarded and frauds have been detected and taken care of. The accounts have been prepared on going concern basis. Directors must admit that adequate measures are taken to regulate internal control and compliance with the existing laws.
- Details of frauds reported by Auditors.
- The Company policy, for a company covered under Section 178, on remuneration and appointment of directors along with the criteria for their selection and the qualifications required.
- Explanations on any adverse remark of the Auditors or the Company Secretary in practice in his Audit report.
- Loans, guarantees or investments undertaken under Section 186.
- Contracts made with related parties under section 188.
- The amount proposed to carry out as reserves and to be paid as dividend: It is the board of Director which recommends the dividend and the general meeting which accepts or rejects the proposed amount. [4]

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[3] A.R. Ramaiya, Guide to the Companies Act, Lexis Nexis, 17th Edn., 2010.
[4] Kesoram Industries & Cotton Mills Ltd. v. CWT 1370 (SC)

- State of Company's affairs.
- Material changes affecting the financial position of the company
- Conservation of energy, technological absorption, foreign exchange earnings and outgo;
- Development and implementation of risk management policy including identification of risk.
- Steps taken for Corporate Social Responsibility.
- Steps taken for internal evaluation of the performance of the Board, its committees and individual directors.
- Other matters as may be prescribed.
- As per the SEBI Guidelines, the Board Report must also contain disclosures w.r.t. employees' stock option scheme.

This report is prepared on the basis of available financial statements on a standalone basis. [5] This report is to be signed by the Chairman of the Board and if any mis-statement appears in the Report, the directors are held as personally responsible in tort to people who relied on those statements.[6]

2.2. Corporate Governance Report

Regulation 34 of SEBI (Listing Obligations and Disclosure Requirement) regulations also require a separate corporate governance report in the Annual Report of the company. The report would have details related to the company policies and philosophy on corporate governance, composition of board, committees and attendance of directors at the meetings.

2.3. The Audit Committee

As per Section 177, every listed company is required to form an audit committee which should consist of minimum 3 directors with independent directors in majority. The Board Report must also disclose the composition of Audit Committee. The Audit Committee has the power to call for the comments of the auditors on the internal control systems, the scope of audit and the review of the financial statements before they are submitted to the board. The Board will then have to answer or respond to any adverse remark made by any auditor in its report. The Auditors and the KMPs have a right to be heard in the meeting of the Auditors committee.

[5] The Companies (Accounts) Rules, 2014
[6] W.B. Anderson & Sons Ltd. v. Rhode(Liverpool) Ltd. [1967] 2 All (R-450)

2.3.1. Functions: The principal function of audit committee is to improve management reporting by over-sighting the audit function, internal control and financial reporting process. The Audit Committee works closely with management, internal and external auditors.[7] This promotes accuracy, high quality and timely disclosure of financial and other information to the Board. In India, there is a mandatory requirement to constitute Audit Committee under the listing agreement as they have the power to investigate and advice the board. Therefore, they can impose statutory sanctions.[8]

2.3.2. Setting of a Vigil Mechanism*:* A vigil mechanism has to be mandatorily set up by the listed companies. Via such a mechanism, the directors and the employees can report genuine concerns about the company and ensure anonymity of the person and prevent him from being victimized. This mechanism can also lead to direct communication between the employees and the chairperson of the Audit Committee.[9]

2.3.3. Drawbacks: A problem with this provision is that it has left scope for its mis-use by providing no criteria or qualification for the chairmanship of the Board. Further, as regards the chairman, it must have been mandatory that he should have the capability to read and interpret the financial statements. Audit Committee is of such importance for Corporate Governance that it recommends the name of the auditors to the Board. [10] Moreover, it is the Audit Committee who possesses the power to define the roles and responsibilities of the Auditors' services. But, this power cannot go beyond the restrictions provided under the Act.[11] This is important in order to ensure that the auditor's independence and objectivity is not compromised because of the fees earned by him.

[7] Mautz,R.K. and Neumann, F.L., "The Audit Committee, its growth and significance in the corporate structure", *The CPA Journal*, 1972.
[8] Section 177, Companies Act, 2013.
[9] Regulation 22, SEBI (Listing Obligations and Disclosure Requirements), 2015.
[10] Section 139(11), Companies (Audit & Auditors) Rules, 2014.
[11] Section 144, Companies Act, 2013.

2.4. Provisions for Conflict of Interest

It is the duty of the director to disclose his interest at a particular transaction.[12] If he fails to disclose such interest, the he can be held personally liable and the contract is held to be voidable at the option of the company. But, where directors are aware of the fact, no formal disclosure is necessary.[13] Such disclosure of interest should take place at the meeting. "Interest" of a director can be interpreted under Section 184(2) as the following:

- If the contract is with a Body Corporate, then association with the director of such Body Corporate or is a promoter, CEO, manager or holds at least 2% shares in that Body Corporate;
- In case of a firm or any other entity that director is the partner, owner or member.

Any person who has been convicted of any offence under Section 188 at any time during the preceding 5 years is disqualified of being appointed as a director. [14] Whenever there is involvement of interest of an individual director, such interest needs to be sanctioned by the Board and such sanction can only be obtained at the meeting of the directors along with the power of the director to enter in a related party transaction.[15] These kind of disclosures have a long lasting impact on the purveyors of capital as they help in gaining confidence and increasing accountability for the suppliers of capital.[16]

2.5. Role of Directors in Corporate Governance

2.5.1. Executive Directors: They are essential for the performance of the Company but their existence in excess could lead to a situation where Board is dominated by the CEO. Wherever, there is a preserve of any type of directors, independence and objectivity become the principal causalities. This happens because the Executive Director is so connected with the outside world, that his views become archaic and prejudiced.

2.5.2. Non-Executive Directors*:* They play a dual role of one, adding shareholder value to companies by assisting in strategic matters and secondly, preventing the erosion

[12] Section 184 of the Companies Act, 2013.
[13] Venkatachalapati v. Guntur Mills AIR 1929 Mad. 353.
[14] Section 164(1) of the Companies Act, 2013.
[15] Section 188 of the Companies Act, 2013.
[16] Lev, Baruch (1992), "Information Disclosure Strategy", California Management Review, pp.9-31.

of shareholder value by guarding against poor decision-making. Therefore, it has been said that the NEDs are part-time outsiders and are ones who have integrity, independence, personality and experience to fulfill their roles.[17] The Cadbury Committee was of the view that the caliber and the number of the NED on the Board has the power and sufficient weight in Board's decision. They even act as a counselor to the Chairman.

2.5.3. Nominee Directors: Generally, his main role is to protect the financial interest of the organization he is representing. But, he has an effective role in checking the financial performance of the Company. Moreover, he keeps a check on inter-corporate investments, Expenditure of the management and the relationship of the Board with the Executive Management. The company is compelled to accept the appointment of such director except when he is incompetent.[18]

2.6. *Independent Directors & Corporate Governance*

Independent Directors have always been considered as the sentinels of Corporate Governance. Independent Directors enjoy a position of high integrity and considered a person of expertise and requisite experience. They are in no way connected with the management of the company but are present to safeguard the interest of all the stakeholders. They must be aware of the conduct or the environment of the organization and whether the affairs of the company are taking place in the manner they are supposed to take place. They are not supposed to get too familiarized with the workings of the organization which is the reason why they are not appointed as independent directors after they have completed two successive terms. They help the company boards to get the most of their business and provide fresh, independent judgment to the strategic thinking and decision making. They are paid remuneration as sitting fees of the meetings. An independent director should not be a promoter, a relative, have any pecuniary interest and nor should be a relative of the person having pecuniary relationship with the company. He or his relation should not be in any direct or indirect relation with the firm. [19]

It is of utmost importance that the independent Directors shall hold at least one meeting in a financial year without the presence of the other members of the Board. The purpose

[17] PRO-NED, *Code of Recommended Practices on NEDs*
[18] British Murac Syndicate Ltd. v. Alperton Rubber Co. Ltd. [1915] 2 Ch. 186.
[19] Section149(2), Companies Act, 2013

of the meeting is to review the performance of the other member and the chairperson of the Board and the type of information being exchanged between the Board and the Management.[20]

It is the duty of the Board to release such information which can help make the shareholders assess that a particular director is independent.[21] Moreover, performance evaluation criteria of the Independent Directors are also to be laid down by the Board.[22]

The reason for this lies in the fact that the existence of Independent Directors can be traced back to Non-Executive Directors who create a wall of difference between themselves and the management and hence, being able to bring in transparency in the organization in some way. The Non-Executive directors play an important role by reviewing the performance of the Board and executives and by taking lead whenever there is a potential conflict. This was the reason why the Naresh Chandra Committee had recommended that in some cases, non-executive Directors can be treated as "independent".[23]

2.7. The Board of Directors & Corporate Governance

- It is the duty of the Directors to act in good faith for the company and not act in any adverse interest those of the stakeholders. He must not achieve any undue advantage to himself or his relatives.[24]

- It is the duty of the directors to attend the Board Meetings. This is important to bring transparency in the organization. If a director fails to attend meeting for 12 months, without a sick leave in between, then his office will be treated as vacant. It is essential if a meeting has been convened on an urgent basis; atleast 1 Independent Director needs to be present in order to ensure that there is no fraud or façade taking place. If this director is also absent for the meeting, then such

[20] Vide MCA Notification dated 5th July, 2017.
[21] Council of Institutional Investors, Core Policies, Positions and explanatory Notes, draft adopted March 31, 1998, p.2.
[22] Supra Note 4.
[23] Recommendation 4.1
[24] Section 166, Companies Act, 2013

decision of the meeting shall be ratified by at least one Independent Director to make it binding on the rest of the Board.[25]

III. CLAUSE 49 OF THE LISTING AGREEMENT

The Listing Agreement applies to all the Companies which are listed under a particular stock exchange. Clause 49 has paved way for Corporate Governance way back in 1999. As per the new Act, and the amendment to Clause 49 therein, there must be an optimum combination of the EDs and the NEDs on the Board with at least 50% presence of the NEDs. A mandatory requirement of having a Woman Director is also imposed on the Company with certain specific turnover.

It is to be noted in a company where the chairman is an Executive Director, the independent directors should comprise of ½ of the population of the Board whereas if it is a Non-Executive Director, they are 1/3 in number.[26]

It is the duty of the Board to lay down Code of Conduct for the Company and must ensure its compliance in the Annual Report. It is of utmost importance that the Code of Conduct is communicated and understood by all the people of the Organization. It affects the integrity, ethics, values and other effects of corporate culture. Moreover, a brief statement must also be published on the website of the Company regarding the company's philosophy on Corporate Governance.

The number and attendance of Board Meetings held must be disclosed. The Resignation letter of the Director must be detailed enough and must be displaced on the company website and the same must be sent to the stock exchange. [27]

Clause 49 also enumerates the setting up of the whistleblower policy in the Company which protect the interests of whistleblower and in turn protect the organization from shams.

3.1. Committees under Clause 49

3.1.1. Audit Committee: The Audit Committee is required to meet at least 4 times in a year. The presence of at least two Independent Directors is necessary at the time of the meeting. The Chairman presiding over such committee must be an

[25] Section 173, Companies Act, 2013
[26] Clause 49, Listing Agreement
[27] Supra Note No. 4

Independent Director and he is responsible to answer to all the queries of the shareholders in the AGM. This Committee is necessary for reviewing financial statements, internal and external auditor's report, business plan, risk factors, statutory and legal compliance.

3.1.2. Nomination & Remuneration Committee: It is important to have a proper charter or the policy laying down the distribution of salaries to the employees and the Directors. Therefore, it is necessary for optimum utilization of funds of the company, that suitable employees are recruited. Therefore, there must be selection of those employees who are not only independent of the managements influence but also possess the business acumen to deal with complex issues. Both the committees must work together to achieve satisfaction for the company. The Committees must be aware of:

- Recruitment and Compensation policies
- Job Description and Compensation elements
- Rewards and Evaluating Performance, etc.

3.2. Case Study: Infosys Remuneration Committee

The Committee at the Infosys comprises entirely of the Non-Executive Independent Directors. They have to review and recommend the pay for the company's senior management and the EDs. This is done only after critical evaluation of their performance. They even make amendments in the performance evaluation criteria.

3.2.1. Shareholders' Grievances Committee: This committee is set for the benefit of the suppliers of capital and the owners i.e. the shareholders. It is constituted for redressing shareholders' concerns and addressing their issues like transfer or forfeiture of shares, declaring dividends or for the receipt of annual report or notice for AGM.

3.2.2. Risk Management Committee: This Committee has to be mandatorily consisted by the top 100 listed companies which is decided by the market capitalization. The major work of this committee involves capital adequacy; interest rate sensitivity, reviews of risk such as liquidity risk, credit risk, investment risk, etc. It involves establishing a link between risk and determination of return and resourcing priorities. [28]

3.2.3. Advent of Corporate Governance Committee: Clause 49 does not insist on setting of such a committee but this committee has been adopted by various Companies. In 1995, there were 7% of the American companies had incorporated Corporate Governance committees.[29] This trend is increasing because the new system of Corporate Governance is asserting a lot of pressure on the traditional committee structure. Tasks such as Shareholder's liaison, succession planning, CEO evaluation, etc. are delicate matters and are prone to Management influences. Hence, there is a requirement of an independent committee to ensure that all the tasks are worked upon in a transparent and enhancing accountability of the over.

3.3. Related Party Transactions

All the related party transactions are permitted only after prior approval of the Audit Committee and if it is of such a nature that it materially affects the shareholders, then a special resolution must be passed at the AGM. It is the duty of the director to details of such transactions must be disclosed quarterly in 1 year. Even the policy on such transactions must be disclosed by the Board.

3.4. Disclosures

There are a lot of mandatory disclosures that the Company is required to make so that transparency is maintained in the organization. Details of Related Party Transactions must be disclosed. Any change in the Accounting Treatment of different items in the financial statements must be disclosed along with the reason for the change. The policy of the risk management, manner of use of proceeds from issuing of shares,etc., the manner of remuneration of the Directors, the Management discussion & Analysis Report which discusses the performance and risks and other considerations of the market, are all disclosures. Lastly, all the information about re-appointment and relationship of the Director

[28] Supra Note No. 2
[29] Survey of Companies, Conference Boards,1995.

must be disclosed to the shareholders. For the purpose of accelerating the process of transfer of shares, the Board has to delegate this power to an officer/ committee or an agent and such person must attend to the requisite formalities.

3.5. Corporate Governance Report

The Annual Report of the Company must include a final report on the compliance of the mandatory requirements of Corporate Governance and reasons for non-compliance with the non-mandatory requirement. A quarterly compliance report is to be submitted to the Stock Exchange on which the company is listed. [30]

IV. STEPS TAKEN BY SEBI

SEBI has developed as protector of interest of shareholders' and ensuring governance since the Satyam Scam. They have mandated the disclosure of pledged shares that a promoter holds in a company and agreements with media companies. They have developed the concept of Peer Review. It is necessary to maintain and update the website of the Company. The major step taken here is that the SEBI has made it mandatory that the CFO appointed must be approved by the Audit Committee in order to ensure that he has the requisite qualifications for the same. Moreover, moving towards an era of technology, SEBI has permitted the shareholders to cast their vote electronically is disclosed off with the voting results.

V. OECD PRINCIPLES ON CORPORATE GOVERNANCE

These are the international principles that are recognized worldwide for their sound financial application. Some of them are the following:[31]

- There is a continuous need for backing of the law and a framework of Corporate Governance.
- Protection of the rights if shareholders and other stakeholders
- All shareholders must be treated Equally
- Mandatory Disclosures must be specified and transparency must be maintained.
- Both the Board and the management must be monitored by each other and the board must be held to be accountable to the shareholders.

[30] Clause 49, Listing Agreement
[31] Improving Corporate Governance in India, Related Part Transactions and Minority Shareholder Protection, OECD, https://www.oecd.org/daf/ca/Improving-Corporate-Governance-India.pdf

Indian Corporate Governance Framework is based on and in compliance with the OECD principles.

VI. CONCLUSION

Corporate Governance has proved to be a mechanism which has represented the Control function and follow-up of all the processes in the Organization and has continued to maintain transparency. It has led to an increase in the shareholder's gains and corporate profits. It has a few arms of its own namely the Directors, the Board and the Committees of the Board. Governance standards are necessary for attracting and retaining institutional investors. Stock Markets reflect the advantages of good governance in the company. This happens because good corporate governance leads to increased trust and transparency in the organization and hence, the shareholder becomes more interested in the company. Therefore, Privatization has always been considered as a good option for the Public Sector Companies in order to increase accountability and the performance. But, Corporate Governance has retained many disadvantages such as a separation between ownership and management of the company has led to a conflict for maximization of shareholder's interest. Moreover, the large amount of Internal Control exercised has led to an increase in Cost and has delayed the speedy process. This has in-turn increased Insider Trading in the organization. Corporate Governance has still got many other avenues to cover in order to be fully efficient namely, family owned businesses. All in all, Corporate Governance has changed the complete scenario in the Corporate Arena.