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A PAPER TO STUDY THE EVOLVING ROLE OF SEBI IN PROMOTING CORPORATE GOVERNANCE IN INDIAN LISTED COMPANIES

Suchita Shukla
Research Scholar
Jiwaji University,
Gwalior (M.P.)

Dr. Nehaa Tripathi
School of Commerce DAVV,
Indore (M.P.)
Address: House No.2 Collector Bungalow
Residency Area Near GPO Indore, M.P.

Abstract

Corporate governance is basically a system by which corporations are directed and controlled and the way directors and auditors handle their responsibilities towards shareholders and other company stakeholders. Typical corporate governance measures include appointing non-executive directors, placing constraints on management power and ownership concentration, as well as ensuring proper disclosure of financial information and executive compensation.

Considering the growing importance of code of best Corporate Governance practices all over the world the capital market regulator have overhauled corporate governance norms for listed companies in India in an effort to improve transparency in their transactions and give minority shareholders a bigger say in management decisions. The rules are in line with India's new companies law that was ratified in 2012 and was designed to enhance shareholder rights.

The purpose of this paper is to examine the new guidelines issued by SEBI for providing more clarity on how Indian companies are run, forming part of government's agenda to attract retail investors back into stocks. The paper takes the form of an exploratory study based on secondary data and draws upon from the materials available in the form of consultative papers, published articles, periodical and related websites to present an overview of the new guidelines introduced by SEBI which will become effective from 1st October, 2014 and how they will benefit the actual owners of the company.

Keywords: Corporate governance, Shareholders, SEBI, Company law

Clause 49 of the Equity Listing Agreement, which deals with Corporate Governance norms that a listed entity should follow, was first introduced in the financial year 2000-01 based on recommendations of Kumar Mangalam Birla committee. After these recommendations were in place for about two years, SEBI, in order to evaluate the adequacy of the existing practices and to further improve the existing practices set up a committee under the Chairmanship of Mr Narayana Murthy during 2002-03. The Murthy committee, after holding three meetings, had submitted the draft recommendations on corporate governance norms. After deliberations, SEBI accepted the recommendations in August 2003 and asked the Stock Exchanges to revise Clause 49 of the Listing Agreement based on Murthy committee recommendations. This led to widespread protests and representations from the Industry thereby forcing the Murthy committee to meet again to consider the objections. The committee, thereafter, considerably revised the earlier recommendations and the same was put up on SEBI website on 15th December 2003 for public comments. It was only on 29th October 2004 that SEBI finally announced revised Clause 49, which will have to be implemented by the end of financial year 2004-05. These revised recommendations have also considerably diluted the original Murthy Committee recommendations. Areas where major changes were made include:

- Independence of Directors
- Whistle Blower policy
- Performance evaluation of nonexecutive directors
- Mandatory training of non-executive directors, etc

Since 2004 SEBI has made minor modifications in the code of corporate governance, most notably in the post Satyam episode. These include amongst others disclosures in terms of promoters pledged shares, general information dissemination on websites, voting results disclosures, peer review of auditors and electronic voting enablement. The Companies Bill, passed by the Lok Sabha in December 2012, has made significant changes that have Corporate Governance (CG) impact. SEBI is now seeking to align with the Corporate Governance (CG) changes proposed in the Companies Bill 2012 as well as other recommendations of MCA voluntary guidelines and the Adi Godrej report. It has also examined good international practices from OECD to the extent they are relevant to India, taking into consideration the concentrated nature of holdings of controlling interest and promoter driven companies. This paper analyses primarily regulations related to increased disclosure by the company in the proposed amendments and prospective benefit to the shareholders of the company as a result.

Objective of the Study

The objective of this paper is

- To study the new amendments issued by SEBI for promoting corporate governance.
- To study whether the adequacy and accuracy of disclosures proposed in the amendments benefit the shareholders.
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Literature Review

Denis & McConnell (2002) defined CG as 'an arrangement of a set of internal and external mechanisms designed and adopted to ensure that self interested managers act to maximize the value of the company to its shareholders'.

At the international level CG has been defined by the Organization for Economic Co-operation and Development (OECD). According to OECD CG is:

> "A set of relationships between a company's management, its board, its shareholders, and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders and should facilitate effective monitoring".

OECD Principles of Corporate governance (2004) and various corporate governance indexes (such as Standard & Poor's Corporate Governance Index) focus on the characteristics of corporate governance mechanism rather than outcomes based on the principles that effective and robust processes result in appropriate results. However authors like Pitabas Mohanty argue that, "if a company has got a governance system then it must get reflected in certain desirable outcomes. If the outcomes are not present, then the mere existence of a process does not amount to anything.

Significant research on this area was conducted by Gompers et al. (2003), Bebchuk and Cohen (2004) and Bebchuk, Cohen and Ferrell (2009) shows that firms with stronger stockholder rights have higher corporate value (measured through Tobin Quotient).

In India, CG has been defined in the Guidelines on Corporate Governance for Central Public Sector Enterprises (2007). According to this:

> 'Corporate Governance involves a set of relationships between a company's management, its Board, its shareholders and other stakeholders. Corporate governance provides a principled process and structure through which the objectives of the company, the means of attaining the objectives and systems of monitoring performance are also set. Corporate governance is a set of accepted principles by management of the inalienable rights of the shareholders as a true owner of the corporation and of their own rule as trustees on behalf of the shareholders. It is about commitment to values, ethical business conduct, transparency and makes a distinction between personal and corporate funds in the management of a company'.

There are differing views about CG. According to Bhagat, Bolton and Romano (2008), 'it is an area where a flexible regulatory regime allowing ample variation across firms is particularly desirable as there is considerable variation in the relation between different governance indices and different measures of performance'. Evidences show that the attitude towards CG varies from institution to institution as well as from nation to nation. Many authors have opined that CG practices vary across institutions environments (Gordon & Roe, 2004; Zattoni & Cuomo, 2008), as well as nations (Aoki, 2001; Gordon & Roe, 2004).

Methodology and Analysis

Present paper is an exploratory study and draws upon only secondary data available on the topic in SEBI'S Consultative papers, official circulars to stock exchanges, periodical and other

published papers on the subject. A detailed study of the material available is done to present an overview of the new amendments to Clause 49 by SEBI.

Gist of Proposals Approved by the SEBI Board

The SEBI Board Approved the Proposals to put in place the following:

1. Policy on dealing with RPTs
2. In case of the appointment of a new director or re-appointment of a director the shareholders must be provided with the following information:
   a. A brief resume of the director;
   b. Nature of his expertise in specific functional areas; Names of companies in which the person also holds the directorship and the membership of Committees of the Board; and
   c. Shareholding of non-executive directors as stated in Clause 49 (IV) (E) (v)
   d. **Disclosure of relationships between directors inter-se** shall be made in the Annual Report, notice of appointment of a director, prospectus and letter of offer for issuances and any related filings to be made to the stock exchanges where the company is listed.
3. Quarterly results and presentations made by the company to analysts shall be put on company's web-site, or shall be sent in such a form so as to enable the stock exchange on which the company is listed to put it on its own web-site.
4. A committee under the Chairmanship of a non-executive director and such other members as may be decided by the Board of the company shall be formed to specifically look into the redressal of grievances of shareholders, debenture holders and other security holders. This Committee shall be designated as 'Stakeholders Relationship Committee' and shall consider and resolve the grievances of the security holders of the company including complaints related to transfer of shares, non-receipt of balance sheet, nonreceipt of declared dividends.
5. To expedite the process of share transfers, the Board of the company shall delegate the power of share transfer to an officer or a committee or to the registrar and share transfer agents. The delegated authority shall attend to share transfer formalities at least once in a fortnight.
6. **Disclosure of resignation of directors**
   a. The company shall disclose the letter of resignation along with the detailed reasons of resignation provided by the director of the company on its website not later than one working day from the date of receipt of the letter of resignation.
   b. The company shall also forward a copy of the letter of resignation along with the detailed reasons of resignation to the stock exchanges not later than one working day from the date of receipt of resignation for dissemination through its website.
7. **Disclosure of formal letter of appointment**
   The letter of appointment of the independent director along with the detailed profile shall be disclosed on the websites of the company and the Stock Exchanges not later than one working day from the date of such appointment.
8. **Disclosures in Annual report**
   i. The details of training imparted to Independent Directors shall be disclosed in the Annual Report.
   ii. The details of establishment of vigil mechanism shall be disclosed by the company on its website and in the Board's report.

iii. The company shall disclose the remuneration policy and the evaluation criteria in its Annual Report

9. E-voting facility by top 500 companies by market capitalization for all shareholder resolutions – however, as per the Act, this is optional.
10. The proposed changes require the Board to disclose the development and implementation of a risk management policy and for the Audit Committee to evaluate internal financial controls and risk management systems.
11. Divestment of major subsidiaries
12. **Responsibilities of the Board as to Disclosure of Information**

i. Members of the Board and key executives should be required to disclose to the board whether they, directly, indirectly or on behalf of third parties, have a material interest in any transaction or matter directly affecting the company

ii. The Board and top management should conduct themselves so as to meet the expectations of operational transparency to stakeholders while at the same time maintaining confidentiality of information in order to foster a culture for good decision-making.

iii. Boards of companies to satisfy themselves that plans are in place for orderly succession for appointments to the Board and senior management.

Independent Directors related proposals

1. Exclusion of nominee director from the definition of Independent Director
2. Prohibition of stock options to Independent Directors
3. Separate meeting of Independent Directors
4. Performance evaluation of Independent Directors and the Board of Directors Independent Directors related proposals
5. It has been decided that the maximum number of boards an Independent Director can serve on listed companies be restricted to seven and three in case the person is serving as a whole time director in a listed company.
6. To restrict the total tenure of an Independent Director to 2 terms of 5 years. However, if a person who has already served as an Independent Director for 5 years or more in a listed company as on the date on which the amendment to listing agreement becomes effective, he shall be eligible for appointment for one more term of 5 years only

Related Party Transactions (RPTs) related proposals

7. Prior approval of audit committee for all material Related Party Transactions (RPTs)
8. Approval of all material RPTs by shareholders through special resolution with related parties abstaining from voting
9. The scope of the definition of RPT has been widened to include elements of Companies Act and Accounting Standards.

Other proposals

10. Compulsory whistle blower mechanism
11. Expanded role of Audit Committee
12. Constitution of Stakeholders Relationship Committee
13. Enhanced disclosure of remuneration policies

14. Mandatory constitution of Nomination and Remuneration Committee. Chairman of the said committees shall be independent
15. At least one woman director on the Board of the company

The Impact of Increased Stress on Transparency & Disclosures in the Proposed Amendments by SEBI

Corporate governance should keep up with the times in a dynamically changing scenario. The proposed Corporate Governance amendment by SEBI will come into effect from October 2014, the real value that these will generate to the shareholders in particular and investors in general will be clear once they come into force. Based on the proposed changes this paper will attempt to examine how increased stress on disclosures will benefit the shareholders.

- The government recognized the need for sectoral regulators to have stringent norms (for example inputs on the role of independent directors and emphasizing that independent directors should really be independent is), to protect the rights of investors and SEBI and the Ministry of Corporate Affairs (MCA), collaborated to set up an inter-regulatory cell to bridge the existing gaps.
- Alongside, the ministry, stock exchanges have also put up warning systems to detect companies which gather funds from capital markets and then vanish. The market regulator, have also attempted at evolving a common platform for submission of annual reports and related information by listed companies which could be made accessible to other exchanges. This should expedite as well as provide a single window for sharing information with investors.
- These amendments will promote credible disclosure of all shareholders' contribution so that the end-use of IPO (initial public offering) money is fair, transparent and goes in the right direction.
- Excessive promoter remuneration, higher royalties to foreign parent companies, loans to wholly owned subsidiaries at low interest rates, intra-group transfers- time and again, would be controlled by proposed regulations for related party transactions by companies and its management. Therefore protecting the interest of minority shareholders from being manipulated.
- The proposed guidelines state “The Company should frame its policies/procedures to facilitate shareholders to obtain effective redress for violation of their rights.” The OECD principles mention this in the context of equitable treatment of shareholders particularly minority and foreign shareholders. But here, whether the intent of the proposed guideline is to safeguard mainly minority shareholders or to provide redress in cases of inequitable treatment or all violations. As there are other redress provisions also available. This needs further clarity.
- As per principle, timely and accurate disclosures should be made not only to selective stakeholders like institutional investors, industry bodies or equity analyst, but to all investors at large in the form of an announcement in the stock exchanges, is a very positive step for protecting the rights of investors.
- Further, it is stressed that all disclosures by companies should also be in electronic format made available to investors at large, not just shareholders. The current practice of making physical documents available at the registered office for inspection by shareholders is outdated and inconvenient.

CONCLUSION

The credibility — and utility — of a corporate-governance framework rest on its enforceability. SEBI, stock exchanges and regulatory organizations with oversight responsibilities should therefore continue to devote their energies to implementation and enforcement of laws and regulations. Court systems should further strengthen their expertise and capacity to adjudicate corporate-governance disputes efficiently and impartially, including through establishment of specialized commercial courts and promotion of alternative dispute resolution. Both agencies and courts should develop procedures that are objective, understandable, open and fair. In addition to enforcing the law, public decision-making should inform the future behavior of market participants and enforcement agents as well as generate public confidence in the state's commitment to the rule of law.

Further disclosures that communicate important information on the competitive strengths of companies to market participants if included will help investors in investment related making decisions.

One of the OECD principles relating to Disclosures & Transparency addresses "Issues regarding employees and other stakeholders". Additional points from the OECD principles should be included and the proposed amendments can be further broadened to have, disclosures on, managements relations with other stakeholders such as creditors, suppliers, and local communities as well as management and employee relations.

However it can be concluded that the proposed principles are fairly comprehensive and cover almost all aspects of the company's governance from a shareholder and stakeholder perspective. Making them mandatory and overriding will help define the boundaries of Governance within which companies can operate.

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