1. **Subject Name: Business Ethics**
2. **Semester / Year: Second (Semester II)**
3. **Name of the Teacher: Pinaki Dey**
4. **Name of the topic: Corporate Governance (Part III)**

19.8 CORPORATE GOVERNANCE IN INDIA

- India has progressed significantly in terms of adopting more robust governance standards and its overall standing in the world for designing effective policies and procedures happens to be quite high.
- Several companies have transcended the mandatory requirements for fulfilling the objectives of corporate governance, and have established robust governance practices that have significantly enhanced the image as well as the quality of corporate governance in India.
- Some of the contemporary ethical governance practices adopted by organizations include separation of the Chair and the CEO, constitution of boards, representation of independent directors, disclosure through a wide range of media and company sources etc.
- India currently is ranked 3rd in Asia and 20th in the world for the overall quality of corporate governance.

19.8.1 Features of Corporate Governance Practices in India

- Corporate governance deals with how corporate organizations are governed, and are concerned about promoting corporate fairness, transparency and accountability.
- The corporate governance framework in India requires listed companies to have independent directors staffing one-third of their Board, disclose all associated party deals, disclose comparative metrics on managerial pay, appoint audit and nomination committees, and require the CEO and CFO to sign off on the governance norms being fulfilled in the financial statements.
- Minority shareholders with 10 per cent voting rights also have the right to drag companies to Court for 'oppression and mismanagement'.
- Some of the relevant features which define the current practices of corporate governance in India are as follows:
  - **Proactive role of SEBI in developing world-class governance systems:** Requirements pertaining to corporate governance in India are largely based on the recommendations of the Cadbury and Higgs Reports and the Sarbanes–Oxley Act. In fact, the SEBI has played a proactive role in sustaining the Indian corporate governance rules and regulations in line with the best practices in the world.
  - **Rise in adoption of corporate governance mechanisms:** The adoption rates of corporate governance in India has improved over the last few years, especially among the large cap Indian companies (i.e., the stocks with a market cap of ₹10,000 crore or more).
  - **Role of globalization as a catalyst in fast adoption of governance mechanisms:** Globalization has served as a catalyst for the fast-paced adoption of corporate governance best practices, instead of the regulatory practices.
  - **High market premiums of companies with good corporate governance measures:** The stocks of companies that abide by good corporate governance measures command high market premiums, which in turn, has reinforced the belief among Indian investors and has provided greater access to cheaper capital.
  - **Voluntary improvements:** The growth and improvements in corporate governance mechanisms in Indian companies are largely voluntary in nature and are driven by the forces of globalization.
  - **Trickle-down impact on smaller companies:** Companies that seek to access capital markets or that seek to become leading global suppliers to corporations in advanced markets are becoming increasingly transparent. They are willing to adopt stronger corporate governance standards, which in turn has a trickle-down effect on smaller Indian companies.

- **Growing vigilance on stock exchanges:** Stock exchanges are often perceived as the most crucial element for the purpose of vigilance. They are monitored frequently to ensure compliance with all listing requirements, as well as those that pertain to corporate governance.

19.8.2 Framework of Corporate Governance in India

- The Companies Act, 2013 is the principal legislation governing companies in India. In addition to the Companies Act, companies are governed by the Securities and Exchange Board of India Act, 1992 (SEBI Act), various regulations notified under the SEBI Act, particularly the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR).
- Companies are also bound by the standard listing agreement of stock exchanges like the Bombay Stock Exchange (BSE) or the National Stock Exchange (NSE), where the shares of the company are listed.
- Companies are also required to adhere to the accounting standards issued by the Institute of Chartered Accountants of India (ICAI), and comply with the secretarial standards issued by the Institute of Company Secretaries of India (ICSI).
- The Ministry of Corporate Affairs of the Government of India had prescribed the Corporate Governance Voluntary Guidelines 2009, in light of the global financial crisis and major corporate failures in India.
- Overall, the Indian framework on corporate governance has been largely in accord with the global standards. Broadly, it can be described in the context of the following organizations/bodies:
  - **The Companies Act, 2013:** It offers provisions concerning Independent Directors, Board Constitution, General meetings, Board meetings, Board processes, Related Party Transactions, Audit Committees, etc.
  - **SEBI Guidelines:** The SEBI Guidelines have ensured the protection of investors and have mandated companies to adhere to the best practices specified in the guidelines.
  - **Accounting Standards issued by the ICAI:** The ICAI is the national professional autonomous accounting body of India that issues accounting standards. The disclosure of financial statements is made mandatory by the ICAI as well, and is backed by the Sec. 129 of the Companies Act, 2013.
  - **Standard Listing Agreement of Stock Exchanges:** It applies to those companies whose shares are listed on various stock exchanges.
  - **Secretarial Standards issued by the ICSI:** The ICSI issues standards on Meetings of the board of Directors, General Meetings, etc. The companies Act, 2013 empowers this autonomous body to provide standards, which every company is required to adhere to, so that punitive measures are not taken against them, under the Companies Act itself.

19.9 CORPORATE GOVERNANCE AND BUSINESS ETHICS

- For the majority of organizations across the world, the fundamental structure of corporate governance starts with the shareholders voting for, and hence empowering a board of directors, who then have a fiduciary responsibility to guard the best interests of the shareholders and the firm itself.
- With the introduction of the Sarbanes–Oxley Act and the setting up of various committees to ensure corporate governance, it has now become legally obligatory for corporations across the world to follow a course of social compliance.
- However, even where the law is silent, the issue of ethics in corporate governance remains highly crucial, irrespective of whether organizations think in terms of a narrow 'shareholder-driven, profits-first perspective', or in terms of a broader 'stakeholder' approach. For example, sometimes, organizations may

undertake activities which are not necessarily ethical or in the best interests of stakeholders, but are well within the confines of legal guidelines and frameworks.

- Business ethics and corporate governance of an organization go hand in hand. In fact, organizations that abide by ethical practices in their activities happen to follow best corporate governance practices as well.
- Corporate governance may be regarded as outright, a matter of ethics, since it indicates who is responsible to whom, and for what, and under what conditions.
- They must hence distinguish between legal corporate governance, which is obligatory in nature and ethical responsibilities in corporate governance.

19.9.1 Legal Duties of Board Members

- Most corporate governance frameworks across the world place the responsibility for steering corporate governance firmly on the board of directors and the top management.
- The law imposes three clear-cut duties on the board members, in the context of corporate governance. They are briefly discussed hereunder:
  - **The duty of care:** It involves the practice of reasonable care by a board member to ensure that the employees and corporate executives working in the organization execute their management responsibilities and comply with the legal frameworks in the best interests of the organization.
  - **The duty of good faith:** It is one of obedience, which requires board members to be faithful to the organization's mission and other broad-based objectives. Put differently, they are not permitted to act in a manner that is inconsistent with the central goals of the organizations.
  - **The duty of loyalty:** It requires faithfulness on the part of board members, who must provide undivided allegiance when making decisions affecting the organization. It implies that conflicts of interest must always be resolved in favour of the organization.

19.9.2 Principles of Ethical Corporate Governance

- In complex business situations, it may take years for regulators, legislature and courts to adopt themselves to the changing business practices. The answers to ethical dilemmas may not always be easily found within the context of rules and regulations governing an industry.
- There are a number of causes for conflicts in the markets and industry, which may or may not be resolved through the simple formation of rules and regulations.
- There are several fundamental principles and responsibilities that the top management and board members should follow in order to ensure appropriate and ethical corporate governance:
  - **Standards:** The principles of governance, created by the independent directors, should be publicly available for the board members.
  - **Independence:** The board should ensure their independence by requiring that the majority of their members be independent.
  - **Selection:** Board members should be selected based on their value structures and not merely by their experiences or roles played in other firms.
  - **Executive sessions:** The independent directors should meet regularly in executive sessions to preserve the authenticity and credibility of their communications.
  - **Committees:** The board must have separate audit and finance committees that are adequately staffed by board members with extensive expertise in such domains.
  - **Leadership:** If the Chairman of the organization and the chair of the board are the same, it is critical that the board select an alternative lead director as a measure of check and balance.

- **Board culture:** The board should not only have the opportunity but also be encouraged to develop a culture that welcomes challenges and embraces diversity.
- **Responsibility:** Board members should recognize their responsibility to provide oversight and to control management through relevant governance processes.

19.9.3 Role of Ethics in Corporate Governance

- The Chairman/CEO as well as the top management of an organization have a special responsibility for promoting integrity throughout the departments of an organization, and assigning responsibilities to stakeholders, both internal and external to the company.
- An organization that has a strong governance mechanism in every aspect, and ensures the maintenance of globally prescribed and accepted corporate governance norms, would be required to implement various ethical practices.
- Some of the ethical principles and practices, which make corporate governance more meaningful in the context of the organization are discussed as follows:
  - **Act with honesty and integrity:** The members of an organization are required to act with uprightness and integrity, by avoiding definite or apparent conflicts of interest in their personal as well as their professional relationships.
  - **Provide comprehensive information:** The board members are expected to provide information that is clear, precise, comprehensive and timely to ensure transparent and logical disclosure in reports and documents that companies file with, or submit to regulators.
  - **Ensure legal compliance:** Ethical practices in corporate governance includes compliance with the laws of the land, rules and regulations that are set forth by the governments and regulatory bodies associated with the business venture.
  - **Maintain responsibility and care:** The members of an ethical organization happen to act in good faith, responsibly, with due care and competence. They do not distort material facts or permit an individual's independent judgement to be subordinated.
  - **Protect confidentiality:** The board members seek to uphold and protect the confidentiality of the information provided in the context of the workplace and do not attempt to disclose it to anyone unless authorized or legally bound to do so.
  - **Prevent personal gain:** The board takes care to ensure that any confidential information that is made available in the workplace is not used to promote personal benefit of any employee or other stakeholders.
  - **Share knowledge and preserve skills:** It is important to share knowledge and preserve vital skills that are relevant to the needs of various stakeholder groups.
  - **Lead by example:** The board must proactively promote and endeavour to serve as a representative of ethical behaviour, by being a responsible partner among colleagues in the work environment as well as in the community.
  - **Uphold responsible stewardship:** The key to sustaining an ethical workplace that is equipped with strong governance measures is to ensure the responsible use of and control over the corporate assets and resources employed or entrusted.
  - **Ensures fair dealings with corporate stakeholders:** Corporate governance mechanisms are designed to ensure the ethical functioning of organizations in a manner that all stakeholders (i.e., creditors,

distributors, suppliers, customers, employees, competitors, the society and governments) are addressed in a fair and transparent manner.

- **Develops self-discipline:** Corporate governance measures by nature are not something, which regulators must impose on an organization's top management for enforcing ethical conduct. In fact, they should come from within.
- **Builds dedication:** There are several provisions in the Companies Act, such as disclosing the interest of directors in contracts in which they are interested, abstaining from exercising voting rights in matters they are interested etc. It is the responsibility of the board members and the top management to ensure that employees abide by such regulations with absolute dedication and not merely for legal compliance.
- **Deters manipulation of the law:** There are multiple grey areas where the law is silent or where the regulatory framework is weak. For example, a new form of corporate fraud may crop up, which is yet to be covered technically under any existing law and hence, cannot be interpreted as violating any of the existing laws. Care must be taken to ensure that organizations do not manipulate such legal frameworks and bypass regulations for their personal gain.

FACT FILE

Recent Corporate Scandals that have Shaken the World

Company	What happened	How they did it	Key players	Penalties
Enron Accounting Fraud (2002)	Shareholders lost $74 billion, thousands of employees and investors lost their retirement accounts, and many employees lost their jobs	Kept massive debts off the balance sheets	CEO Jeff Skilling and former CEO Ken Lay	Lay died before serving time; Skilling got 24 years in prison; the company filed for bankruptcy; Arthur Anderson was found guilty of fudging Enron's accounts
Lehman Brothers Scandal (2008)	Concealed over $50 billion in loans disguised as sales	Allegedly sold toxic assets to Cayman Island banks with the understanding that they would be bought back eventually. This created the impression that Lehman has $50 billion more cash and $50 billion less in toxic assets that it really did.	Lehman executives and the company's auditors, Ernst & Young	Forced into the largest bankruptcy in U.S. history. Securities And Exchange Commission (SEC) did not prosecute due to lack of evidence.
Satyam Computer Services Scandal (2009)	Falsely boosted revenue by $1.5 billion	Falsified revenues, margins and cash balances to the tune of ₹50 billion	Founder/ Chairman Ramalinga Raju	Raju and his brother charged with breach of trust, conspiracy, cheating and falsification of records.