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Companies Bill, 2011 as a Wakeup response for Corporate Misgovernance and Scandals in Indian Corporate Sector

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ABSTRACT

"Corporate Governance is concerned with holding the balance between economic and social goals and between individuals and communal goals. The corporate governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society."

- Global Corporate Governance Forum, World Bank, 2000

Corporate governance is the key of corporate excellence. It extends beyond good corporate performance and financial propriety. Its essence has been considered after experiencing a crucial phase of corporate crises during 1970-1990, which include scam and scandals in developed countries like U.S.A., U.K. etc. As a wake up response to major financial scam and corporate failures, need to tighten surveillance over corporate framework and behaviour was realised. Effort articulating standards for corporate governance took its root in U.K. and U.S.A as early as in 90's and later to other countries also. The Foreign Corrupt Practices Act, 1977 (USA), OECD Principles of Corporate Governance (1999 and 2004), Sarbanes-Oxley (SOX) Act, 2002 (USA) and UNCTAD Guidance on Good Practices in Corporate Governance Disclosure, 2008 (UK) are some of the initial steps taken towards the corporate governance.

Corporate governance has also been under constant scrutiny as an issue that has gained widespread importance in Indian scenario. Its significance was realised after experiencing the Harshad Mehta stock scam during 1992. Which lead to various initiatives in the form of guidelines, in order to strengthen corporate governance by ensuring transparency and responsible Board structure. '*Desirable Code on Corporate Governance*' initiated by CII in 1998 was one of the first initiative in this direction. Subsequently, scam in *Satyam Software Services Ltd.* during 2009 made a dent on prevailing statutory provisions of Companies Act, 1956 and lead to fill gaps by strengthening existing Companies Act. New Companies Bill, 2011, which has been introduced in Lok Sabha is being treated as a wakeup response for corporate misgovernance and scandals in Indian corporate sector.

Present paper is an insight to some well-known corporate misgovernances in Indian Corporate sector, highlighted as case studies and likely counter measures/safeguards in recently introduced Company Bill, 2011.

Keyword: *Corporate Governance, Scandal, Unethical Business Environment, Misgovernance and Companies Bill, 2011*

Introduction

Debates on effective corporate governance are all time issue. Corporate misgovernance, collapses and frauds have left the serious concern for almost every corporate in the world, to establish a mechanism for safeguarding the business from any collapse or fraud in coming future. Worldwide experiences force strictly to adopt the principle and guidelines of corporate governance as suggested from time-to-time, particularly in the era where reputed companies failed due to unhealthy business practices.

Companies like Enron, HIH, WorldCom, Parmalat, Global Crossing, Xerox, Tyco and Satyam reflects as some of the examples, which were initially known for their good governance and had gained major share in the market. Later on, various misgovernance practices such as, misappropriate accounting policies, misleading statements, unethical business practices, lack of transparency and disclosures caused heavy losses to the shareholders as well as other stakeholders. All such companies were exposed to probable threats, particularly when the principles of corporate governance were not followed or lacunae in adopting all measures suggested by different regulatory bodies. As a result, economies interlinked to these corporate affairs

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have collapsed several times resulting heavy losses to shareholders and other stakeholders associated to these companies.

Corporate governance, being the key of corporate excellence and implication extending beyond good corporate performance and financial propriety. As a wake up response to major financial scam and corporate failures, need for tight surveillance over corporate framework and behaviour was realized after experiencing a crucial phase of corporate crises during 1970-1990, which include scam and scandals in developed countries like U.S.A., U.K. etc. Effort articulating standards for corporate governance took its root in U.K. and U.S.A as early as in 90's and later to other countries as well. The Foreign Corrupt Practices Act, 1977 (USA), OECD Principles of Corporate Governance (1999 and 2004), Sarbanes-Oxley (SOX) Act, 2002 (USA) and UNCTAD Guidance on Good Practices in Corporate Governance Disclosure, 2008 (UK) are among some of the initial steps taken towards the corporate governance.

Corporate governance has been under constant scrutiny as an issue, which gain widespread importance in Indian scenario; realised after experiencing the Harshad Mehta stock scam during 1992. Leading to various initiatives in the form of guidelines, in order to strengthen corporate governance by ensuring transparency and responsible Board structure. 'Desirable Code on Corporate Governance' initiated by CII in 1998 was one of the first initiatives in this direction. Subsequently, scam in *Satyam Software Services Ltd.* during 2009 made a dent on prevailing statutory provisions of Companies Act, 1956 and lead to fill gaps by strengthening existing Companies Act. New Companies Bill, 2011, which has been introduced in Lok Sabha is being treated as a wakeup response for corporate misgovernance and scandals in Indian corporate sector.

International Scenario

International scenario of corporate instability and failure is not restricted to developed or developing countries. It is Indeed a phenomenon attracted attention world over for any such organisation ignoring any of the five principles of corporate governance, *i.e.,* fairness & integrity, transparency & disclosures, accountability, equitable treatment to all shareholders and social responsibility. The most common reasons for corporate failures and scandals were lax board, fraud, lack of transparency and inadequate disclosure, failure of internal/external audit and unethical business conduct. Some renowned and high volume corporate failures leading the foundations for significant role of corporate governance in the globalised era, are summarised as under-

The Barings Bank in UK failed during 1995 by losing more than $1 billion in unethical behaviour of trading. The HIH Insurance, an Australia based company, met losses of around US$5.3 billion during 2001 due to inefficient Board, ineffective audit committee and poor decision making under the dominance of its CEO. In the same year Enron, a US based company reported an accounting loss of US$618 million and reasons identified for misgovernance were unethical corporate functioning, lax board and misreporting of financial statements. During 2002, six US based companies namely, Tyco, Xerox Corporation, Global Crossing, World Com, Adelphia Communications and Andersen Worldwide reported corporate failure and scandals. Major problems noticed in these cases was misreporting of financial statements, lax and conflicted board, external audit failure, unethical behaviour, etc.

An accounting fraud of 14 billion Euros was reported in Italy based Parmalat Company during 2003 because of the falsified accounting documents. In the same year Netherland based Royal Ahold faced a problem of insider trading and unethical behaviour. In the subsequent year 2004, China Aviation Oil (Singapore/China based company) reported a loss of more than US$500 million. The reasons reported for such losses involve insider trading, misleading statements, etc.

At the international front safeguarding corporates from financial scandals and future misgovernances was the serious concern of developed countries, especially for the USA and UK where maximum corporate scandals have been reported, *i.e.,* 12 and 4, respectively. As a result, several committees constituted to address such issues have introduced various codes and standards on corporate governance. Table-1 below refers to some of the committees setup to address the issues of corporate governance along with their major recommendations. (See Table-1)

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Table-1
Various International Committees on Corporate Governance

Sl.	Name of Committee/ Report	Year	Country	Issue Addressed/ Major Suggestion
1.	Sir Adrian Cadbury Committee	1992	UK	Addressed financial aspects and recommended code of best practices
2.	Greenbery Committee	1995	UK	Disclosure provisions, remuneration policy, service contracts and compensation, etc.
3.	Bosch Report	1995	Australia	Composition of Board and directorship
4.	Vienot Report	1995	France	Board membership and cross shareholding
5.	CalPERS Global Corporate Governance Principles	1996	USA	Independent directors
6.	Hampel Committee on Corporate Governance	1998	UK	Audit committee, internal control and board responsibility
7.	Combined Code of Best Practices, London Stock Exchange	1998	UK	Board effectiveness
8.	Blue Ribbon Committee	1999	USA	Improving the effectiveness of Audit Committee
9.	OECD Principles of Corporate Governance	1999	-	Shareholders rights, role of stakeholders and Board, audit, disclosure and transparency.
10.	CACG Guidelines for Corporate Governance in Commonwealth	1999	-	Corporate Compliances, effective internal control, etc.
11.	Euroshareholders Corporate Governance Guidelines	2000	Europe	Membership of non-executive directors on Board.
12.	Principles of Good Governance and Code of Best Practices	2000	UK	Defined Principles of Good Governance and Code of Best Practices
13.	Joint Committee on Corporate Governance	2001	Canada	Regular assessment of board and its committees, CEO selection, etc.
14.	King Report on Corporate Governance for South Africa	2002	South Africa	Board function and composition, Director's evaluation, Codes of Directors and audit, etc.
15.	Sarbanes-Oxley (SOX) Act	2002	USA	Preventing investors, ensuring transparency and disclosure
16.	Smith Report on Audit Committee	2003	UK	Strengthening of audit committee
17.	Higgs Report	2003	UK	Effective Board composition and Accountability, etc.
18.	Revised Combined Code	2003	UK	Board composition, separate role of the Chairman and Chief Executive.
19.	OECD Principles of Corporate Governance	2004	-	Revision of existing OECD codes (1999)
20.	UNCTAD Guidelines on Good Practices in Corporate Governance Disclosure	2008	UK	Corporate reporting, Discharge of Board duties in the interest of shareholder.

Source: Compiled from respective committee report/Acts.

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National Status

In India, the Companies Act, 1956 was the principal legislation, providing the formal structure for corporate governance. The Monopolies and Restrictive Trade Practices Act, 1969, the Foreign Exchange Regulation Act, 1973 (which is now replaced by the Foreign Exchange Management Act, 1999), the Industries (Development and Regulation) Act, 1951 and some other legislations, which had a bearing on the corporate governance principles. In addition to various legislative frameworks, there are certain regulatory bodies, which ensure functioning of specific sector. Regulatory philosophy revolves around the regulatory roles and the power vested in the regulation authorities along with basic principles like fairness; transparency in dealing of the regulator and the regulated; consistent compliance pro-activeness, quality, professionalism and the self-regulation. (See Table-2 for various regulators in India)

Table-2
List of Sector Specific Regulators in India

Sector	Regulator
Corporates	Ministry of Corporate Affairs (MCA)
Capital market and stock exchanges	The Securities and Exchange Board of India (SEBI)
Money market and banking	Reserve Bank of India (RBI)
Insurance (life and non-life)	Insurance Regulatory and Development Authority (IRDA)
Communication	Telecommunications Regulatory Authority of India (TRAI)
Foreign business	Foreign Investment Promotion Board (FIPB)
Imports and exports	Foreign Exchange Management Act (FEMA), Directorate General of Foreign Trade DGFT)
Intermediaries, banking companies and insurance business	Financial Intelligence Unit – India (FIU-IND)
Listed companies, stock brokers	Stock Exchanges (NSE, BSE)
Various Professions	Professional Institutes like ICSI, ICAI, ICWAI etc.

As far as country-wise corporate failure and scandals is concern, India is still a much preventive country, as compare to U.S.A. and U.K., in terms of less number of corporate failure and amount of volume involved in accounting loss. According to the survey on effectiveness of corporate governance, conducted by the World Economic Forum during 2003; UK, Sweden, USA, Singapore and Germany are ranked among the top ten countries in the ranking of 49 countries on the parameter of effective corporate governance. However, India in this ranking was placed at 32nd position (See Liu, 2006).

Code for the corporate governance was first introduced in India, in the form of 'Desirable Code of Corporate Governance' issued by Confederation of Indian Industries (CII) during 1998 brought after the Harshad Mehta stock scam (1992). Thereafter, several other initiatives and guidelines were framed to strengthen existing framework of corporate governance. SEBI's Kumara Mangalam Birla Committee (2000) and Justice V. Bala Krishna Eradi Committee (2000) are two of them. Subsequently, two other scams - Stock Market Collapse (Ketan Parekh Scam) (2001) and Global Trust Bank failure (2002) made a major dent on existing legal framework and provisions of existing Companies Act, 1956. This has lead to rethink on various gaps and problems in existing framework of corporate governance.

Stock Market Collapse (Ketan Parekh Scam), 2001

Year 2001 was bed dream for many, including big financial institutions and banks. The modusoperandi was to build up a worthy and strong image of few stocks, especially after the annual budget announcement. Mr. Ketan Parekh acquired all such funds for investment in the security either from cooperatives or from other banks, fraudulently. He got pay-orders and bankers cheques from his near once without any collateral as security, which were further discounted from other

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banks. He also acquired funds of Rs.515 crore from Zee Telefilms, Rs.700 crore from Hindustan Futuristic Communications Ltd and Rs. 256 crore from GTB bank.

Parekh's had massively invested in selected stocks and raised the stock prices, causing a sharp jump in SENSEX, BSE and NSE. However, the Bear Run manages to act on counter of Bull Run. As a result, money invested in purchasing low prices stock at a high price and thereafter, lowering down the price resulted in the loss of almost all invested fund which ultimately cause a big loss to all those who had funded Mr. Ketan Parekh. Still the valuation of scam is incomplete and it highlights the misgovernance in all such funding agencies.

Global Trust Bank Failure, 2002

The Global Trust Bank commenced its business in 1994 in India as a leading private sector bank, which later merged with the Oriental Bank of Commerce (OBC) in 2004. GTB reported an approximate loss of Rs.1200 crore. The regulatory vigilance failed due to misgovernance of funds and involvement of top management in malpractices such as window dressing. It was also reported that heavy advances of around Rs. 800 crore were made to corporates such as Zee Telefilms, HFCL & others at a very high risk. This has caused a negative net worth. The overall evidence of misappropriation of funds was found, as the involvement of bank's top management with Ketan Parekh who is well known for 2001 stock market collapse.

Further to ensures the scope of fairness, transparency and accountability some other committees have been setup to recommend guidelines to strengthen corporate governance by ensuring transparency and responsible Board structure, etc. Some of such committees are as follows along with major issues addressed by them. (See Table-3)

Table-3
Various Committees on Corporate Governance in India

S.No	Name of the Organisation and Committee/ Report	Year	Issue Addressed/ Major Suggestion
1.	Confederation of Indian Industry (CII) 'Desirable Code of Corporate Governance'	1998	17 recommendations to develop and promote a code for effective corporate governance, including, Board composition, Audit Committee, etc.
2.	SEBI's Kumar Mangalam Birla Committee	2000	Recommended to incorporate new clause 49 to the listing agreement and covers: Board composition, Audit Committee, Directors' remuneration and mandatory disclosures
3.	Dr. P.L. Sanjeeva Reddy	2000	Examined ways to operationalise the concept of corporate excellence on a sustained basis, so as to 'sharpen India's global competitive edge and to further develop corporate culture in the country'. Also recommended for raising governance standards among all companies in India. It also suggested the setting up of a Centre for Corporate Excellence.
4.	Reserve Bank of India (RBI), Report of the Advisory group on Corporate Governance	2001	Compared corporate governance in India with internationally recognized codes and standards.
5.	SEBI's Y.H. Malegam Committee	2001	Suggested enhanced transparency and disclosure norms.
6.	Prof. Y.K. Alagh Committee	2002	Resulted the Companies (Amendment) Act, 2002, which brought manufacturing types of cooperative societies in the country under the purview of Companies Act.

7.	The Naresh Chandra Committee	2002	Examine the Auditor-Company relationship, role of independent directors' disciplinary mechanism over auditors in the right of irregularities committed by companies in India and abroad
8.	SEBI's N.R. Narayana Murthy Committee	2003	Reviewed the existing code on corporate governance to assess adequacy of existing practices and suggested improvements to the existing practices
9.	The Revised Clause 49	2004	Board composition and procedure, Audit committee responsibilities, Subsidiary companies, Risk management, CEO/CFO certification of financials and internal controls, Legal compliance, Other disclosures, Non mandatory compliances
10.	Dr. J. J. Irani Committee on Company Law	2004	Charting out the road map for a flexible, dynamic and user-friendly new company law

Source: Compiled from respective committee report.

Even after several measures and guidelines, Indian corporate sector passed through a shocking phase during 2009 after experiencing the biggest-ever corporate scandal in India.

Satyam Software Services Ltd. Scandal, 2009

Satyam Software Services Ltd. established in 1987 was an IT company. The Chairman of company, Mr. Ramalinga Raju and other made a forgery and fraud, which reported during 2009, with an estimated fraud of over Rs.7,000 crore. It made a surprise in the market, as company had received 'Golden Peacock award on Corporate Governance' from World Council for Excellence in Corporate Governance, London during 2008, just one year back to the scandal. The reasons of the company failure are as follows:

- The strong position of assets and liquidity was shown in the balance sheet, which never existed.
- Unconvinced role of Independent Directors
- Compliances mentioned under SEBI clause 49 not adopted completely.
- Top management influenced the company's principle accounting policies and made falsified invoices and statements.
- Company's huge fund was inappropriately utilized and money laundering adopted.
- Unauthentic business exercises by the senior management and fraudulent internal auditor.
- Inequitable distribution of powers among the key personals of the company.
- Dubious role of rating agencies

Company Bill 2011: A Wakeup Response

The Companies Act, 1956 was active for about fifty-five years and has been amended several times. As a replacement to existing Company Act, 1956, New Companies Bill, 2011 has been introduced in the Lok Sabha on 15th December 2011 with new additions and amendments. Bill has strengthened the position of companies by addressing the pitfalls of corporate governance. The Bill contains 470 clauses and 7 schedules as against 658 Sections and 15 schedules in the previous Companies Act, 1956. Bill received a strong opposition; as a result bill could not be passed and, therefore, has been referred to 'The Parliamentary Standing Committee on Finance' for a fresh scrutiny in view of large amendments and suggestions of the stakeholders. Some of the important remedial aspects introduced under the new Companies Bill are discussed below:

Enabling Transparency, Clause 120

In order to bring transparency in companies, a new Clause on 'maintenance and inspection of documents in electronic form', has been introduced, which ensures to provide any document, record, register or minute, etc., to be kept in the electronic form or allowed for inspection. This E-governance initiative enables a transparent environment including maintenance and inspection of documents in electronic form, option of keeping of books of accounts in electronic form, financial statements to be placed on company's website, holding of Board meetings through video conferencing or any other electronic mode, voting through electronic means, etc.

Corporate Social Responsibility, Clause 135

Corporate Social Responsibility, has been framed under clause 135, enabling to constitute a Corporate Social Responsibility Committee of the Board for every company having net worth of Rs.500 crore or more, or turnover of Rs.1,000 crore or more or a net profit of Rs.5 crore or more during any financial year. Mandate of such committee is to formulate and monitor CSR policies of the company. It become mandatory to ensure that the company spends, in every financial year, at least 2% of the average net profits, made during three immediately preceding financial years. This policy initiative is having two fold effects *viz.*, one on the various social sectors and activities including education, health, hunger & poverty, gender equality & women empowerment, environmental sustainability, vocational skills & employment, etc. and second on the corporate response on the CSR compulsion.

Appointment of Auditors, Clause 139

It provides that a company shall appoint an individual or a firm as an auditor at annual general meeting subject to his written consent who shall hold office till conclusion of sixth annual general meeting. It also has provisions for rotation of Auditors.

Structure of Board of Directors, Clause 149

This Clause corresponds that every company shall have a Board of Directors with minimum and maximum number of directors prescribes on Board. Prescribed class or classes of companies shall have atleast one women director. The clause also seeks to provide that every company shall have at least one director who stays in India for a total period of not less than 182 days in the previous calendar year. It enforced all listed companies to appoint Independent Directors at least one-third of the size of Board. Independent Directors shall hold office upto two consecutive terms. One term is upto five consecutive years. It also mentioned that Nominee Director appointed by any institution, or in pursuance of any agreement, or appointed by any Government to represent its shareholding shall not be deemed to be an Independent Director. The clause further provides for the provisions of rotation of independent director. Further the provision of retirement of directors by rotation shall not be applicable to appointment of Independent Directors. The clause also provides that an Independent Director or a Non-executive Director who is not a promoter or key managerial personnel shall be held liable for acts of omission or commission by a company which has occurred by his knowledge.

Duties of Director, Clause 166

Duties of Director have been defined under this Clause, which provide that a director of a company shall act in accordance with the company's articles. In case of contravention, director is punishable with fine and if a director is found guilty of making any undue gain either to himself or to his relatives, partners or associates, he shall also be liable to pay an amount, equal to that gain, to the company. The duties of Director have been defined and include the following:

- To act in accordance with the articles of the company.
- To act in good faith in order to promote the objects of the company
- To exercise his duties with due and reasonable care, skill and diligence and shall exercise independent judgment.
- Not to involve in a situation in which he may have a direct or indirect interest that conflicts, or possibly may conflict, with the interest of the company.
- Not to achieve or attempt to achieve any undue gain or advantage either to himself or to his relatives, partners, or associates
- Not to assign his office and any assignment so made shall be void.

Structure of Audit Committee and Its Function, Clause 177

It provides the requirement and manner of constitution of audit committee. The Audit Committee shall consist of a minimum of three directors with independent directors forming a majority and majority of members must have ability to read and understand financial statements. The further provides the functions of audit committee. The clause also provides for the establishment of vigil mechanism in every listed and prescribed class of companies.

Prohibition on Insider Trading of Securities, Clause 195

This Clause prohibits directors or key managerial person of the company to deal in securities of a company, or counsel, procure or communicate, directly or indirectly, about any non-public price-sensitive information to any person. This Clause also have a penalty provision with imprisonment for a term upto five years or with fine upto five lakh rupees extendable to 25 crore rupees or three times the amount of profits made out of insider trading, whichever is higher, or with both.

Appointment of Key Managerial Personnel (KMP), Clause 203

Under this Clause, it is required for every company belonging to such class or description of companies, as prescribed by the Central Government, shall have managing director, or chief executive officer or manager and in their absence, a whole time director and a Company Secretary, as whole-time key managerial personnel. It is also specified under this clause that a whole-time key managerial personnel shall not hold office in more than one company (expect in a subsidiary at the same time except that of a director if company permits him in this regard. This clause further provides for punishment in case of contravention.

Clause 203 also has provision that Company Secretary will be appointed by a resolution of the Board, which shall contain the terms and conditions of appointment including the remuneration. If any vacancy in the office of KMP is created, the same shall be filled up by the Board at a meeting of the Board within a period of six months failing which, heavy penalty is imposed.

Secretarial Audit for Bigger Companies, Clause 204

Under this Clause, every listed company and companies belonging to prescribed class or classes of companies shall annex a secretarial audit report given by a Company Secretary in practice with its Board's report. The Board in its report shall explain any qualifications or other remarks made by the Company Secretary in practice. The clause further provides penalty for the company or any officer of the company or the Company Secretary in practice.

Defined Functions of Company Secretary, Clause 205

This Clause specifies the functions of Company Secretary. The functions are inclusive in nature and inter alia provides for ensuring compliance with the applicable secretarial standards. The clause further provides that specified functions shall not affect the duties and functions of Board of Directors, Chairperson, Managing Director or Whole-time Director. Functions of the Company Secretary include, reporting the Board about compliances, to ensure that the company complies with the applicable secretarial standards and to discharge such other duties as may be prescribed.

Establishment of Serious Fraud Investigation Office, Clause 211 and 212

These Clauses empowers the Central Government to constitute Serious Fraud Investigation Office (SFIO), which will be headed by a director (not below the rank of Joint Secretary) and will consist of experts from various disciplines. It provides statutory status to SFIO enabling it to investigate into such cases of companies involved in frauds as may be assigned to it by Central Government.

Conclusion

Causes of corporate failure exist more within the organization. In contrary external events may cause a crisis. Indeed, it is the nature of organizational response to these events, which determines their success or failure. The determining principles of corporate success are more or less similar in all cases; the path to failure may differentially vary. On reviewing the cases of corporate misgovernance, some elements appear to be identical, which had closely effected the overall functioning of these companies. Involvement of senior level management as key players of misgovernance; adoption of unethical business practices; ignorance of standard setting accounting norms and business policies; lack of whistler blowing mechanism & inefficient role played by the auditors are some of the key component of such practice. With the introduction of new Companies Bill, 2011, every single gap, which has possibility for corporate misgovernance is covered, however, future events may hold scope as feedback for this Act.

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