Research Paper Commerce

Good Corporate Governance Practice With Special Reference to Indian Companies Act, 2013

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ABSTRACT

The term 'Corporate Governance' conveys about how a corporate body is directed and controlled under a set of mission, values, and philosophy. It is a phrase implying greater transparency of management system in corporate entities. Good corporate governance practice is obligatory for the integrity of corporations as it has a greater impact on the growth and stability of the economy. The increasing corruption in the various government departments and their services had kept the political and corporate leaders above the accountability. For this reason the cost of corporate frauds in the government departments and services finally passed on the vulnerable consumers of their products. The corporate scams and frauds are the area of concern for the government, regulators, policy makers and corporate leaders because at last it will either interrupt the operations of a corporation or introduce extra cost results in coming down of profitability. Professionalization of management, transparency in operation, and corporate democracy are the core of the good corporate governance and these must be applied in genuine actions by the corporate entities to ensure rich corporate culture and sustainable business environment.

KEYWORDS

Good Corporate Governance, New Companies Act, 2013, Professionalization of Management, Transparency in Operation, Corporate Democracy

Introduction

'Good Governance' is drawing much attention of the general public at large and becoming very popular within the academic and professional world as well. Good Corporate Governance practice helps in restoring investors' confidence in the market as it is characterised with transparency in operation, accountability of managers and governors, potential for out-performance in developing countries, improve share price performance at stock exchanges and attracts new investors. It is important to note that the 'Good Corporate Governance' goes hand in hand with increased 'Transparency' and Accountability'.

Review of Literature

Chakraborty (2005) has made a detailed study on corporate governance system in India and opined that India has one of the best corporate governance laws but poor implementation together with socialistic policies of the pre-reform era has effected corporate governance.

Kumar (2010) argued that external factors cannot enforce good governance and further improvement is not possible if the board does not want good governance to happen and tried to focus on self-regulation by board.

Agarwal and Mendury (2013) highlighted good governance as a tool for preventing corporate frauds.

Pandya (2013) highlighted the significant responsibilities of an auditor and auditing committee for protecting the interest of shareholders and investing community.

Ponduri et. al. (2014) focussed their study on various corporate frauds, genesis of frauds and the role of regulatory bodies in overcoming those frauds.

Objectives of the Study

The paper mainly presents brief descriptions of the different literature in the area of corporate governance and makes introspection into corporate frauds in Indian business environment after LPG. This paper also analyses the various attempt those were made by the different organisations and agencies to instigate the 'Good Corporate Governance' practises for the efficient and effective operation of the corporations by their boards. Finally, the paper recommends the practice of 'Good Corporate Governance' for improving corporate culture for long term sustainability.

Methodology

The present endeavour is descriptive and conceptual in nature. With a view to attain the objectives of the study mainly secondary data has been used. Some essential data have been collected from internet by searching different allied websites.

There is no denying the fact that the series of corporate scams have completely shook the confidence of the Indian investors after LPG. Some scams may be mentioned as follows:

Corporate Scams in India:

Harshad Mehta Scam (1992), Vanishing Companies Scam (1994), M.S.Shoes Scam (1994),Sesa Goa Scam(1995),Rupangi Impex Ltd. and Magan Industries Ltd. Scam(1995), Plantation Companies Scam Scam(1996), C.R.Bansali Scam(1997), Mutual Fund Scam(1998), Information Technology Scam(2000), Ketan Parikh Scam(2001), USB Securities Scam Scam(2004), Satyam Scam (2009),

Development of Corporate Governance Practices in India

Consequent upon a number of scams and failures in the corporate sector in the late 1980s and the early 1990s the Cadbury Committee was set up in May 1991 by the financial Reporting Council, the London Stock Exchange, and the accountancy profession to address the financial aspects of corporate governance. Its final report was published on 1st December, 1992. The contents of the report are divided into three parts: i) Code of Best Practices (CBP), ii) roles of auditors and recommendations to the accountancy profession and iii) rights and responsibilities of shareholders. Following the recommendation of this committee many countries of the world took the suggested practices in order to improve the level of their respective corporate governance.

For the first time in the history of corporate governance in India, the Confederation of Indian Industry (CII) prepared a voluntary code of corporate governance for listed companies in 1996.

The other committees are i) The Kumar Mangalam Birla Committee and Clause 49 ii) The Companies Amendment) Act, 2000, iii) Reserve Bank of India, 2001, iv) Naresh Chandra Committee, 2002 v) Narayan Murthy Committee, 2003 and vi) Dr. J.J.Irani Committee, 2005

The Companies Act, 2013

The pattern of corporate governance depends on the economic and business environment of that country which is created by the public governance system. The

The Companies Act, 2013 is a major milestone in the area of corporate governance in India. It aims at improving corporate governance standards, simplifying regulations and enhancing the interests of minority shareholders.

The concept of new class of company i.e. One Person Company (OPC) has been introduced which is a new vehicle for individuals for carrying business with limited liability [Section 2(62)]. The new Act requires that no company should enter into Related Party Transaction contracts pertaining to specified transactions.

In line with the worldwide trend towards promoting 'gender diversity' in board (Catalyst, 2011), the Companies Act 2013 made a revolutionary attempt by introducing quota for women directorship in board. Section 149(1) and Rule 3 of Companies (Appointment of Directors) Rule, 2014: Every listed company and all other specific class of public company shall appoint at least one woman director in board.

The concept of Independent Directors (IDs) has been introduced as per Section 149(4) read with Rule 4 of Companies (Appointment and Qualification of Directors) Rules, 2014. It prescribes that the listed companies should have at least one-third of the total number of directors and the specific large class of Public Companies must have at least two directors. As per Section 149(6) an ID in relation to a company means a director other than a nominee director.

Section 178(2) of the new Companies Act defines the performance evaluation of IDs. This section requires the Nomination and Remuneration Committee shall carry out evaluation of every director's performance excluding the presence of the director being evaluated. On the basis of the report, it shall be determined whether to extend or continue the term of appointment of the ID. The companies Act 2013 also covers and specifies code of conduct of independent directors.

The provision of Corporate Social Responsibility has virtually changed the colour and content of corporate responsibility and conferred a unique social role by providing statutory framework in companies Act 2013. By virtue of this provision corporate entity, instead of being merely an inanimate entity has emerged more as animate personality. This provision requires every company having net worth of Rupees 500 crores or more, or turnover of Rupees 1000 crores or more or a net profit of Rupees 5 crores or more during any financial year shall constitute a Corporate Social Responsibility (CSR) Committee of the Board consisting of three directors, out of which at least one director shall be an independent director (Section 135). The Board of every company shall ensure that the company spends in every financial year at least 2% of the average net profit of the company made during the three immediately preceding financial years in pursuance of its CSR policy.

Provision for reorganization of Board Committees is a better step towards good governance. As per Section 177 the Board of Directors (BODs) of all specific class of major public companies shall constitute an Audit Committee with a minimum of three directors with Independent Directors forming a majority provided that majority members including Chairperson shall be persons with ability to read and understand the financial statement. The roles and responsibilities of the members of the Audit Committee have also been defined in the new Act. For the first time it has been mention in the Act very clearly that the auditor cannot provide the services like accounting and book-keeping and internal audit services, design and implementation of any financial information system, actuarial services, investment advisory services, investment banking services, outsourced financial services, management services and any other kind of consultancy services to the company, its holding company or its subsidiary company or associate company.

Section 178 specifies that the BODs of all specific class of major public companies shall constitute a Nomination and Remuneration Committee consisting of three or more Non-Executive Directors out of which not less than one half shall be independent directors. Section 178(6) stipulates that BODs of a company which consists of more than one thousand shareholders, debenture holders and any other security holders at any time during a financial year shall constitute a Stakeholders Relationship Committee consisting of a chairperson who shall be non-executive director and such other members as may be decided by the board to consider and resolve the grievances of security holders of the company.

The New companies Act for the first time has defined Financial Statement which includes:

- A Balance Sheet as at the end of financial year;
- A Profit and Loss account, or in case of a company carrying on any activity not for profit, an income and expenditure account for the financial year.
- Cash Flow statement for the financial year
- A statement of changes in equity, if applicable and
- Any explanatory note annexed to, or forming part of any document referred to in sub-clause (i) to sub-clause (v) provided that the financial statement, with respect to One Person Company, Small Company and Dormant Company, may not include cash flow statement.

As per Section 132 the Central Government may by notification, constitute a national Financial Reporting Authority(NFRA) to provide for matters relating to accounting and auditing standard under this Act. This section has not been brought into force and the rules with regard to constitution and functioning of these bodies are yet to be finalised. Section 132(4) specifically provides that notwithstanding anything contained in any other law for the time being in force, the NFRA shall have the power to investigate the matters relating to professional misconduct for prescribed class of body corporates or persons. It further provides that in case NFRA has initiated action no other Institute or Body shall initiate or continue any proceedings in such matters of misconduct.

Besides above initiatives various other changes have been suggested in corporate governance practice for its qualitative improvements.

Conclusion

Companies Act 2013 is potentially a landmark legislation that had been in the process of making over ten years and large body stake holders were involved at different stages of making the draft final. So it is obvious that the legislation is likely to have far reaching implication not only upon the corporate sector of the country alone but also upon Government and professional bodies as to how they act upon the means for professional transformation.

Corporate governance extends beyond corporate law. Its fundamental objective is not mere fulfilment of requirements of law, but to ensure commitment of the board of directors in managing the company in a transparent manner for maximizing long-term shareholders' value. Since Professionalization of management, transparency in operation and corporate democracy are the core of the corporate governance so effectiveness of the system of corporate governance cannot be legislated by law nor can any system of corporate governance remain static. In a dynamic business environment the corporate governance system needs to continually evolve in accordance with the rapidly changing economic and industrial environment of the country. In the age of competitive environment India has no other option than to follow good corporate governance practices to achieve sustainable growth and win over the confidence of the investors including different stake holders.

A good corporate governance demands that a company must have a responsibility to set exemplary standards of ethical behaviour, both within the organisation as well as in their external relationships, by virtue of which the company can achieve 'value addition' in terms of stability and growth, confidence, reduction of perceived risks, reduction of cost of capital, stability and long–term sustenance of stakeholders relationship, position of pride and exemplary governance credentials.

Even in the present age of keen competition, practise of good corporate governance would certainly create and improve the competitive advantages over the rival firms. Good corporate governance is considered as the development tool in the hands of Indian corporate world to create a sustainable business environment.

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