COMPANIES ACT, 2013 – A NEW WAVE OF EFFECTIVE REGULATION AND CORPORATE GOVERNANCE IN INDIA

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Abstract:

Corporate India continues to evolve at a fast pace, and besides driving industrial growth is witnessing the emergence of a diverse set of stakeholders. The surge in natural consequences such as risk and default seems to be visibly impacting the virtues of governance. There are close to one million registered companies in the country today which are increasingly looking beyond domestic boundaries to access pools of financial and human capital and forge alliances with foreign companies .Foreign investors are looking towards India as an attractive investment destination. In such a situation, it becomes the responsibility of the government to provide an effective legal structure for corporates. The financial development of any nation depends on strong investor protection and good governance.

The recently enacted Companies Act, 2013 is landmark legislation with far-reaching consequences on all companies incorporated in India. The New Companies Act, 2013 is replacing old Companies Act, 1956. The New Companies Act, 2013 makes comprehensive provisions to govern all listed and unlisted companies in the country. The New Companies Act, 2013 is partially made effective w.e.f. 12th September, 2013, by way of implementing 98 Sections and repealing the relevant sections corresponded with Companies Act, 1956.

The Act in a comprehensive form purports to deal with relevant themes such as investor protection, inclusive agenda, fraud mitigation, internal control, director responsibility and efficient restructuring. The Act is also quite outward looking and in several areas attempts to harmonize with international requirements. Indian companies will have to closely examine these developments to develop a clear strategy at ensuring compliance per the new requirements. The present paper traces the corporate governance reforms brought in by the new Companies Act, 2013 and their implications.

Keywords: *Corporate, Companies Act, Governance, Efficient Restructuring, Fraud mitigation and Investor Protection.*

Introduction:

Today, the term Corporate Governance is the buzzword in global business and regulatory communities. It occupies mind space of the government, regulators, corporates, boards, markets, employees, investors and almost the entire society as one of the most important business constituents given its all-pervasive characteristic. Across the world, innovative governance practices are evolving in response to the global financial crisis, wave of privatization, activity and integration in the capital markets, rising investment levels, greater stakeholder awareness and the urge to survive and thrive in uncertain times. Globally, governments and law-makers are endeavouring to legislate good governance while promoting and disseminating the understanding of best practices for voluntary adoption. Regulators are keen to deter non-compliance. Industry and responsible corporates are constantly striving for exemplary corporate behaviour by designing corporate governance structures and processes with strong emphasis on risk management, enhanced transparency and greater stakeholder engagement.

In the recent times when the corporate sector across the globe was hit by scandals and big companies like Enron, WorldCom bridled with questionable corporate policies collapsed. India too had its share of scam with Satyam being an incident thought to be the first of its kind. Though reforms in the area of corporate governance have been underway since 1990s, it was not until the Satyam scandal that exposed glaring gaps in the governance structure and auditing practices in the country that acted as a catalyst for a modern legislation. The Companies Act, 2013 is a move by the government to strengthen the corporate governance framework in a country where most of the businesses are characterised by concentrated shareholding and channelling of funds. The Act encourages good governance practices by placing the onus on independent directors to bring oversight in the functioning of the Board and protect the interest of minority shareholders.

Objectives of the study:

The present study tries to assessing the risks & loopholes associated with the current corporate governance practices within the country and the revolutionary changes that are made through the introduction of New Companies Act, 2013. Thus, the present study is an endeavour to discuss the corporate governance reforms brought in by the new Companies Act, 2013 and their implications.

What Constitutes Good Governance?

Corporate Governance may be defined as a set of systems, processes and principles which ensure that a company is governed in the best interest of all stakeholders. It is the system by which companies are directed and controlled. It is about promoting corporate fairness, transparency and accountability. In other words, 'good corporate governance' is simply 'good business'. It ensures:

- Adequate disclosures and effective decision making to achieve corporate objectives;
- Transparency in business transactions;
- Statutory and legal compliances;
- Protection of both shareholder and stakeholder interests;
- Commitment to values and ethical conduct of business.

The fundamental objective of corporate governance is to enhance shareholders' value and protect the interests of other stakeholders by improving the corporate performance and accountability. Hence it harmonizes the need for a company to strike a balance at all times between the need to enhance shareholders' wealth whilst not in any way being detrimental to the interests of the other stakeholders in the company. Further, its objective is to generate an environment of trust and confidence amongst those having competing and conflicting interests. It is about commitment to values, about ethical business conduct and about making a distinction between personal and corporate funds in the management of a company. Ethical dilemmas arise from conflicting interests of the parties involved. In this regard, managers make decisions based on a set of principles influenced by the values, context and culture of the organization. Ethical leadership is good for business as the organization is seen to conduct its business in line with the expectations of all stakeholders.

Satyam Scandal – The Country's Biggest Corporate Governance Failure:

On January 7 ,2009 , the landscape of corporate governance changed forever in the country and sent shock waves amongst the shareholders, government, regulators and analysts when the chairman of the fourth largest IT exporter of the country, Satyam Software services Ltd. confessed to colossal fraud of over 7000 crores. It was the biggest case of corporate governance failure which highlighted daunted gaps in the accounting and auditing practices in the company and inefficacy of a system which places reliance on a board comprising of independent Directors to provide oversight in the functioning of the company. Satyam boasted of 6 independent directors on its Board with excellent credentials yet none of them ever questioned the practices of the chairman least of all to detect the massively concealed fraud in the books of accounts until the chairman himself spilled the beans. Satyam's books comprised of huge amounts of non-existent interest accrued, overstated debtors and understated liabilities. The government acted swiftly post the uncovering of this fraud; the chairman B.Ramalinga Raja who single handedly orchestrated the fraud and his brother were arrested, investigations were undertaken by CBI, SFIO (Serious Fraud Investigation Office), Securities Exchange Commission of US (SEC), senior audit partners of international audit firm, PriceWaterhouseCoppers were jailed because of their hand in glove working with the promoter. The board of Satyam was replaced by Government appointed nominees who managed to absolve the situation by handing over the operations of the tainted company to Tech Mahindra in a global bidding process. The Satyam episode brought to the fore a multiple of corporate governance flaws such as : Unethical conduct , Insider Trading, Fraudulent accounting, dubious role of auditors and Audit Committee, ineffective board handpicked by the promoter, failure of independent directors, non disclosure of promoter pledging of shares, unreliable credit rating system and so on

Post Satyam episode - Corporate Governance Reassessment:

A number of measures were taken by the industry and regulators to address the corporate governance situation in the country post the Satyam episode.

In 2009, CII formed a task force headed by former cabinet secretary Naresh Chandra which came out with its report enumerating a set of voluntary recommendations with an objective to establish higher standards of corporate governance in the country.Based on these recommendations, Ministry of Corporate affairs issued Voluntary guidelines,2009.The National Association of Software and Services Companies (NASSCOM), also formed a Corporate Governance and Ethics Committee chaired by Mr. N. R.Narayana Murthy, a leading figure in Indian corporate governance reforms. The Committee issued its recommendations in mid-2010, focusing on stakeholders, audit committee, whistleblower policy and shareholders ‘rights

In November 2009, SEBI announced that they would amend the Listing Agreement to address disclosure and accounting concerns. SEBI instituted these amendments in early 2010 . SEBI also made some policy changes for better governance of listed companies such as disclosure of promoters pledging of shares, peer reviewed auditor, appointment of CFO by audit committee, disclosure of voting rights, mandatory e-voting facility.

In 2010, the Institute of Companies Secretaries of India came out with recommendations to strengthen corporate governance framework in the country.

In March 2012, Ministry of Corporate Affairs constituted a committee under the Chairmanship of Mr.Adi Godrej, Chairman, Godrej Industries Limited, to formulate policy document on Corporate Governance. In

September, 2012 the Committee submitted its document, specifying seventeen guiding principles on corporate governance.

COMPANIES ACT, 2013-REDEFINING LEGISLATIVE FRAMEWORK

With 9.5 lakh companies in 1956, to close to one million companies presently, India has come a long way. Indian economy is expanding, Indian companies are harnessing resources internationally and foreign investors are operating in the country keen to access its untapped potential. In order to strengthen the integrity of India's capital markets and make it an attractive investment destination, a strong regulatory framework was required. As a result, Companies Bill, 2009 was introduced in the Lok Sabha and received president's assent on 29th Aug, 2013. The purpose of the government was to simplify the law, provide principles covering all aspects of governance of corporate entities and a framework for their administration in a single legislation.

Objectives behind re-enacting the New Companies Law:

The main objectives of the New Companies Act, 2013 can be highlighted as below:

1. Bringing Flexibility & Adoption of Internationally Accepted Practices
2. Effective protection for different sections of Society
3. Self Regulation with more disclosures
4. Stringent Punishment for violation
5. Efficient enforcement of law
6. Healthy Growth of Indian Economy

The Act, amongst other things, focuses on good corporate governance practices by increasing the roles and responsibilities of the Board, protecting shareholders' interest, bringing in a disclosure based regime and built in deterrence through self regulation. The 2013 Act significantly changes the way companies are governed. In the following section, we look at the corporate governance changes effected by the present Act.

1) Independent Directors

Under 1956 Act, there was no requirement to have IDs. However, under the Listing Agreement, the Board of listed entities having non-executive chairman and executive chairman should comprise of at least one-third and one-half of the Board as ID respectively.

Number of Independent Directors

The 2013 Act proposes that the Board of listed entities should comprise at least one-third of the Board as ID as opposed to Clause 49 , which requires at least 50% IDs in case the chairperson is in an executive capacity or a promoter or related to a promoter, and hence this represents a dilution from the existing position.

Definition of Independence

The definition of an ID has been considerably tightened. The definition now includes positive attributes of independence, which was excluded from Clause 49 by stating that the candidate must be "a person of integrity and possess the relevant expertise and experience" in the opinion of the board. Every ID is also required to declare that he or she meets the criteria of independence.

Appointment

One of the key criticisms of the current regime for IDs is that they are appointed like any other director, thereby leaving promoters with tremendous influence in determining the identity of the IDs. That has been partially addressed by making a nomination and remuneration committee mandatory (a departure from clause 49 that does not mandate a nomination committee). The committee is required to consider candidates for appointment as IDs and to recommend them to the board. The Act contemplates the establishment of a data bank of IDs, from which persons may be chosen by companies.

Tenure

In order to ensure that IDs maintain their independence and do not become too familiar with the management and promoters, minimum tenure requirements have been prescribed. The initial term shall be 5 years, following which further appointment of the director would require a special resolution of the shareholders. However, the total tenure shall not exceed 2 consecutive terms.

Remuneration

Under the Act , IDs are entitled only to fees for attending meetings of the board, and possibly commissions within certain limits. The Act expressly disallows IDs from obtaining stock options is companies. Roles and Functions Schedule IV of the Act contains a code that sets out the role, functions and duties of IDs and incidental provisions relating to their appointment, resignation and evaluation.

Liability

In order to balance the extensive nature of functions and obligations impose on IDs, the Act seeks to limit their liability to matters directly relatable to them. The Act limits the liability of an ID “only in respect of acts of omission or commission by a company which had occurred with his knowledge, attributable through board processes, and with his consent or connivance or where he had not acted diligently.”

Miscellaneous provisions

The Companies Act mentions that performance evaluation of independent directors shall be done by the entire Board of Directors, excluding the director being evaluated. The Act also provides for separate meetings of Independent Directors at least once a year. In these meetings, Independent Directors would be expected to examine internal controls and general governance practices prevailing in the company and bring out any inefficiency to the attention of shareholders and their report in this regard may form part of the annual report. Independent directors are also required to disclose reasons for their resignation in the form of notice to the Board. Independent Directors have been excluded from retiring by rotation.

2) Board Functioning

Appointment of Board

The 2013 Act provides that the company shall have a maximum of 15 directors on the Board and appointing more would require approval of shareholders through a special resolution .The Act aims at ensuring effective functioning and wider perspectives on Board by bringing in diversity. The Act provides for appointment of at least one woman director on the Board for such class or classes of companies as may be prescribed. A company should have at least one director who has stayed in India for a total period of not less than hundred and eighty two days in the previous calendar year. The 1956 Act did not prescribe any academic or professional qualifications for directors. The 2013 Act provides that majority of members of Audit Committee including its Chairperson shall be persons with ability to read and understand the financial statements. For the first time, duties of the directors are defined under the 2013 Act.

Disqualification of directors

The 2013 Act includes the following additional grounds of disqualification: A person who has been convicted of an offence dealing with related party transactions at any time during the past five years. The directorship in private companies has also been brought under the ambit of disqualification on ground for non-filing of annual financial statements or annual returns for any continuous period of three years, or failure to repay deposits for more than a year. This makes scrutiny of directions more stringent and checks on related party transactions.

Number of Directorships

The 1956 Act provided for maximum directorship of not more than 15 companies excluding Private companies, Unlimited companies, Section 25 Companies, alternate directorship and Foreign companies.

The 2013 Act provides that a person cannot have directorships (including alternate directorships) in more than 20 companies, including 10 public companies.

Restriction on power of Board

The Board can act on certain prescribed matters only after obtaining the consent of the members by a special resolution. This has been made applicable to private companies also which was not the case under 1956 Act.

Board reports and responsibility statement

The 2013 Act seeks to make the board's report more informative with extensive additional disclosures to bring transparency in the functioning of the Board. Important disclosures include : a statement indicating development and implementation of a risk management policy for the company ; internal financial controls to be followed by the listed company and they are whether they are adequate and operating effectively; Related party transactions not in the ordinary course of business and not at arm's length basis etc. The Board shall disclose the composition of an Audit Committee and where the Board had not accepted any recommendation of the Audit Committee, the same shall be disclosed along with the reasons.

3) Committees of the board

a. Nomination and Remuneration Committee

The 1956 Act did not provide for the constitution of a Nomination and Remuneration Committee. Under the Listing Agreement listed entities have an option to constitute a Remuneration Committee under non mandatory clause. The 2013 Act requires that Board of Directors of every listed company shall constitute the Nomination and Remuneration Committee consisting of three or more non-executive directors out of which not less than one half shall be independent directors. Such committee shall identify persons who are qualified to become directors and recommend to the Board their appointment and removal, carry out their performance evaluation and ensure that the pay comprises of an optimum balance between fixed and variable component. As per the Act, listed companies need to disclose in the Board's report, the ratio of the remuneration of each director to the median employee's remuneration and such other details as may be prescribed. This will bring about transparency in disclosure of remuneration policies.

b. Stakeholder Relationship committee

The 1956 Act did not require the constitution of Stakeholders Relationship Committee. Presently, Clause 49 requires constitution of 'Shareholders/Investors Grievance Committee', under the chairmanship of a non-executive director for specifically looking into the redressal of investors' complaints like transfer of shares, non-receipt of balance sheet, non-receipt of declared dividends etc. Clause 178 of the 2013 Act mandates that a company with more than 1000 shareholders, debenture holders, deposit holders and other security holders at any time during the financial year shall constitute a Stakeholders Relationship Committee to consider and resolve the grievances of security holders of the company. This will protect the interest of other stakeholders apart from equity investors.

c. Audit Committee

The 1956 Act required public companies having paid-up capital of more than Rs 5 crore to constitute audit committee, consisting of minimum three directors and two-third of total members to be directors other than Managing Director (“MD”) or Whole Time Director (“WTD”) of the company. Further, Clause 49 requires listed entities to constitute audit committee with two-third of the members to be IDs. As per the 2013 Act, audit committees have been made mandatory for listed companies and other prescribed classes of companies. The Act provides that audit committee should consist of minimum of three directors with Ids forming majority. The role of the audit committee includes the following activities as per the 2013 Act. a) The recommendation for appointment, remuneration and terms of appointment of auditors of the company. b) review and monitor the auditor's independence and performance, and effectiveness of audit process; c) examination of the financial statement and the auditors' report thereon ;d) approval or any subsequent modification of transactions of the company with related parties’) scrutiny of inter-corporate loans and investments; f) valuation of undertakings or assets of the company, wherever necessary; g) evaluation of internal financial controls and risk management systems; h) monitoring the end use of funds raised through public offers and related matters. Risk management and pre approval of related party transactions by the Audit Committee are significant changes to ensure good governance. Presently, the audit committee reviews RPTs on a periodic basis after such transactions have taken place. Such reviews are of limited use as the transaction could not be undone even if the Audit Committee expresses negative opinion on the transactions.

d. Corporate Social Responsibility Committee

India has become the first country in the world to make CSR a statutory requirement by mandating specified companies to spend at least two percent of its average net profits made in the preceding three financial years on government approved categories of CSR. This move is expected to go a long way in improving the social welfare of the country and is heralded as a significant corporate governance move. The 1956 Act did not mandate a company to spend on CSR activities and consequently, there is no requirement to constitute a CSR Committee. The 2013 Act provides that every company having net worth Rs. 500 crore or more, or a turnover of Rs. 1000 crore or more or a net profit of rupees five crore or more during any financial year should constitute a CSR Committee of the Board, consisting of minimum of three directors (at least one independent director) that will devise, recommend, and monitor CSR activities, and the amounts spent on such activities, to the rest of the board. The committee shall prepare a report detain the CSR activities undertaken and if not, the reasons for failure to comply.

4) Audit and Auditors

Auditors play an important role in lending credibility to the financial statements and dubious role of auditors has been the common link in all the accounting scandals over the world. In order to tighten the grip on auditors, the Act lays down stringent rules for their practice and their liabilities.

5) Related Party Transactions

A third of Indian Companies are family owned giving rise to possibility of channelling of funds to related parties. In Case of Satyam also, its downfall began with the promoter's intention to buy two of its family controlled companies. This erodes investor’s confidence and undermines the integrity of capital formation mechanism to curb abusive related party transactions, the Act lays down stringent provisions. The 2013 Act As against the term “relative” defined under the 1956 Act, the 2013 Act defines the term “related party” for the first time. The 1956 Act and the Listing Agreement do not require specific approval of the related party transactions by the Board/shareholders. However, Listing Agreement requires listed entities to present list of related party transactions and other related information to the audit committee. The 2013 Act proposes that all related party transactions which are not in the ordinary course of business or not at arm's length basis should be approved by the Board. The Act also proposes that for the companies with the prescribed share capital, no contract or arrangement or transactions exceeding prescribed amount, shall be entered into with its related party, unless, approved by the shareholders of the company by way of a special resolution. However, the related party shareholders are not permitted to exercise their voting rights, in such special resolution. The Act also proposes that a company shall not make investments through more than two layers of investment companies, unless the investments are in an overseas company and the company has overseas subsidiaries and such layers are permitted under the local law of the company being acquired or under the law of the acquiring company. Every contract or arrangement entered into with a related party shall be referred to in the Board's report along with the justification for entering into such contract or arrangement.

6) Class Action Suit

Though there were provisions for oppression and mismanagement, there is no express recognition of class action suits in Companies Act, 1956. Indian corporate laws were not equipped to deal with the aftermath of scandals i.e compensating the aggrieved investors. However, Clause 245 of the Companies Act, 2013 expressly provides for class action suits and Clause 125 provides for re-imbursement of expenses incurred in class action suits from the Investor Education and Protection Fund.

Class action suits, allow a requisite number of members or depositors with common interest, in a matter, to file an application in the National Company Law Tribunal ('NCLT') against the company/its management/its auditors or a section of its shareholders for damages or compensation if they are of the opinion that the management or conduct of the affairs of the company are being conducted in a manner prejudicial to their interest. This will empower minority shareholders and protect their interests. However, to prevent misuse of this provision would be a challenge.

7) Separating the position of Chairman and MD/CEO

Holding of two positions by the same person leads to unfettered power of decision making .In most of the developed jurisdiction like US, UK France it is a requirement to segregate the role of Chairman and CEO. According to the Act, chairperson of the company, in pursuance of the articles of the company, as well as the managing director or Chief Executive Officer of the company at the same time unless,— (a) the articles of such a company provide otherwise; or (b) the company does not carry multiple businesses

8) Making installation of Whistleblower Mechanism compulsory

Till date, the Companies Act, 1956 contained no guidelines for protection of whistleblowers. Clause 49 requires listed companies to develop and communicate a mechanism to channelize employee complaints to the Board, under non mandatory provisions. Looking at the growing number of scams in the country and international legislations in place, it is imperative that India also has a well laid out whistleblower mechanism in place. The 2013 Act fills this gap and provides every listed company or such class or classes of companies, as may be prescribed, shall establish a vigil mechanism for directors and employees to report genuine concerns in such manner as may be prescribed. The vigil mechanism shall provide for adequate safeguards against victimization of persons who use such mechanism and make provision for direct access to the chairperson of the Audit Committee in appropriate or exceptional cases.

9) E-Governance Initiatives

In order to ensure good governance and participation of all shareholders in voting matters, the 2013 Act specifically recognises electronic voting by members. Participation in Board meeting through video conferencing has been recognised. Maintenance and allowing inspection of documents by companies in electronic form Registration process has been made faster and compatible with e-governance.

10) Prohibition of Insider Trading

Companies Act, 1956 did not contain any clause w.r.t insider trading. SEBI has prescribed Insider trading Rules in India. New clause has been introduced with respect to prohibition of insider trading of securities under the

2013 Act. The definition of price sensitive information has also been included. No person including any director or KMP of a company shall enter into insider trading except any communication required in the ordinary course of business or profession or employment or under any law. This is a step towards harmonization between the 2013 Act and the SEBI Act; more specifically for listed companies; Any person who violates the clause will be punished with a cash fine or imprisonment or both.

11) Penalties

The 2013 Act proposes significant penalties for directors for defaults in discharging his duties. It is noted that the instances for levying penalties have increased substantially too.

Apart from the above provisions the bill also contains provisions like new definitions for Associate Company, One Person Company, Small Company, Related Party, Turnover, matters relating to securities, dividend, incorporation, mergers and acquisition, accounts etc have been provided but are not being discussed in the present paper due to the scope of the paper.

CONCLUSION:

"Great performances, higher profits, expanded reach; nothing would act as safeguards for a company when governance and ethics take a back seat."

The concept of corporate governance has been attracting public attention for quite some time in India. Corporate governance has become an issue of worldwide importance. The corporation has a vital role to play in economic development and social progress. It is the engine of growth internationally increasingly responsible for providing employment, public and private services, goods and infrastructure. The efficiency and accountability of the corporation is now a matter of both private and public interest and governance has thereby come to the head of international agenda.

Therefore we can say the recently enacted Companies Act, 2013 is landmark legislation by the government. Many provisions pertaining to independence of directors, auditors, strict disclosure norms and protection of investors will have wide implications and bring in greater transparency and accountability in the working of the company and at the same time, minimise the incidents of corporate frauds. Companies and stakeholders should start evaluating their position vis-à-vis that required under the new regime and make strategies accordingly. The Act is forward looking in nature and is at par with international best practices. However, the effectiveness of this legislation, like all other, will depend on its implementation. The Ministry of Corporate Affairs should issue circulars and clarifications to ensure smooth implementation of the provisions. Corporates should ensure that they follow the law not just in letter but in spirit also as the true value of Corporate Governance lies beyond compliance.

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