INDIAN JOURNAL OF LEGAL REVIEW

VOLUME 4 AND ISSUE 4 OF 2024

INSTITUTE OF LEGAL EDUCATION

INDIAN JOURNAL OF LEGAL REVIEW

APIS – 3920 – 0001 | ISSN - 2583-2344

(Free and Open Access Journal)

Journal's Home Page – https://ijlr.iledu.in/

Journal's Editorial Page - https://ijlr.iledu.in/editorial-board/

Volume 4 and Issue 4 of 2024 (Access Full Issue on - https://ijlr.iledu.in/volume-4-and-issue-4-of-2024/)

Publisher

Prasanna S,

Chairman of Institute of Legal Education (Established by I.L.E. Educational Trust)

No. 08, Arul Nagar, Seera Thoppu,

Maudhanda Kurichi, Srirangam,

Tiruchirappalli – 620102

Phone : +91 94896 71437 - info@iledu.in / Chairman@iledu.in

INDIAN JOURNAL OF LEGAL REVIEW [IJLR – IF SCORE – 7.58]

VOLUME 4 AND ISSUE 4 OF 2024

APIS – 3920 - 0001 *(and)* ISSN - 2583-2344

Published by

Institute of Legal Education

https://iledu.in

DECODING SEBI's GUIDELINES CORPORATE GOVERNANCE IN CHARTING NEW STANDARDS FOR INDIAN COMPANIES

AUTHORS - MAYUR SHRESTHA & RIYA YADAV, STUDENTS AT SCHOOL OF LAW, PRESIDENCY UNIVERSITY, BANGALORE

BEST CITATION – MAYUR SHRESTHA & RIYA YADAV, DECODING SEBI's GUIDELINES CORPORATE GOVERNANCE IN CHARTING NEW STANDARDS FOR INDIAN COMPANIES, INDIAN JOURNAL OF LEGAL REVIEW (IJLR), 4 (4) OF 2024, PG. 955-960, APIS – 3920 – 0001 & ISSN – 2583-2344.

ABSTRACT

The article focuses on corporate governance in the context of large privately held companies in India against a fast-evolving regulatory framework. It also analyses the role played by Securities and Exchange Board of India (SEBI), the most important regulator of securities market and the Indian corporate world in improving the corporate governance standards of India. In the past, company law, accounting standards, and internal auditing within the corporation were used to describe corporate governance in a broad sense. However, as corporate India evolved in the 1990s, Indian corporations had to start implementing corporate governance principles and practices. Since the late 1990s the concept of Corporate Governance as "the policy, process, structure and information used for direction and controlling the management of an entity" began to take shape with the establishment of Securities and Exchange Board of India (SEBI) in 1992. SEBI has made numerous efforts to enhance India's corporate governance system. To raise the bar for corporate governance, however, a lot of work must be done at the individual business level.

Keywords: Regulators, SEBI, Corporate Governance, Indian Corporate, Compliances.

INTRODUCTION

Over the past ten years, there have been major and profound changes in the Indian corporate sector. Decades of relative isolation were broken by the economic reform program, which also undermined the traditional sources of domination and slow progress of a substantial and influential class of family enterprises. A sizeable portion of that story focuses on how international forces have been transforming the Indian economic sector, including the establishment of a modern banking system, intense competition for Indian enterprises, and significant changes in the stock market. Transparency is highly valued because of all of this. However, as one industrialist stated during this study, "One of the banes of Indian family-owned business is keeping their holding close to their chest." This is one of the reasons why few corporates enjoy openness. The widespread lack of credibility has been exacerbated by self-dealing, account manipulation, corruption in the distribution of funds, and the subordination of boards to management.

Since business families are loath to cede power and company management lacks trust with investors, India, which is still a developing nation, can hardly afford to live under the shackles of a corporate system that stifles growth. To create a credible and professionally driven business system that has the potential to improve living conditions for the vast majority of people, corporate governance is therefore essential not in the mechanical sense of a magic wand that will help companies boost their share prices.

Global uniformity in the regulations governing international company is another aspect of corporate governance. However, these

INDIAN JOURNAL OF LEGAL REVIEW [IJLR – IF SCORE – 7.58]

VOLUME 4 AND ISSUE 4 OF 2024

APIS – 3920 - 0001 *(and)* ISSN - 2583-2344

Published by

Institute of Legal Education

https://iledu.in

regulations can be interpreted in two different ways: (a) less broadly, to refer mainly to the responsibility of boards to shareholders and how that can and should be improved; or (b) more broadly, to encompass broader issues that impact business operations and the rights of shareholders and other stakeholders. The SEBI Code itself serves as evidence of this contrast of viewpoints since it touches on important matters whose resolution is left to other committees and regulatory bodies. These include the takeover code, insider trading laws, and the modernization of Indian accounting standards and disclosure requirements. Whichever viewpoint we opt for, consistency is important because today's influential institutional investors operate across a variety of global markets and look for commercial and legal frameworks that will reduce the "cultural" risk to their investments.

In India's case, Sir Adrian Cadbury's personal, if symbolic, connection to the widely reported CII meetings- where Indian business made its first public statements on the need for companies to take the issue of corporate governance seriously and institute minimal reforms in the functioning of boards and levels of transparency- strongly highlighted Cadbury's influence.[1445] Since then, there have been two corporate governance codes promoted, one possibly with more authority or approval than the other. There has also been a significant public discussion about the need for governance reform in the Indian corporate sector and the part played by financial institutions in this process.

CODES OF CORPORATE GOVERNANCE

In February 2000, the Securities and Exchange Board of India issued a letter to all the stock exchanges proposing that 'a new clause, namely clause 49, be incorporated in the listing agreement'. Eight sections under Clause 49, "Corporate Governance," address the Board of Directors, Audit Committee, Director Remuneration, Board Procedure, Management, Shareholders, Report on Corporate Governance, and Compliance, in that manner. The salient features are as follows:

- In the future, independent directors should make up at least one-third of the board; "independence" is defined as any significant financial relationship or transaction with the company, aside from the director's compensation, which the board determines may compromise a director's ability to make independent decisions.
- Companies shall have a 'qualified and independent' audit committee with most independent directors.
- The Annual Report shall disclose details of the remuneration of directors.
- The Annual Report should contain a Management Discussion and Analysis 'as part of the director's report or as an addition there to.'
- A specific section on corporate governance that describes adherence to the mandatory and optional requirements put forth by SEBI must be included in annual reports.

While the letter to the stock exchanges describes the various provisions as 'requirements,' both the draft and the final report of the Kumar Mangalam Birla Committee refer to them as 'recommendations.' The Committee saw itself drafting recommendations, presumably because it saw itself pursuing an exercise in voluntary compliance. However, taken together these proposals may not go far in bringing about the kind of reform that can bring the mainstream of businesses in India into line with best practice in corporate governance. There are at least three reasons why this is so. First, the SEBI Code itself departs from international best practice in key respects which are outlined below. Second, it is still too early to say how far listing agreements can be an effective mechanism of compliance

[1445] https://www.semanticscholar.org/paper/Corporate-Governance-in-India%3A-The-Transition-from-Varottil/ec0c901b02e941aedac62bb50cabd6bbcca622db.

INDIAN JOURNAL OF LEGAL REVIEW [IJLR – IF SCORE – 7.58]

VOLUME 4 AND ISSUE 4 OF 2024

APIS – 3920 - 0001 *(and)* ISSN - 2583-2344

Published by

Institute of Legal Education

https://iledu.in

with a code of best practice. The exchanges may not desire or be able to fulfil the function of compliance monitors, as evidenced by SEBI's subsequent suggestion to the government that "the listing agreement be substituted by listing rules which are statutory in nature." Indeed, there is considerable scepticism on this score. Third, the Cadbury model, which is the ostensible inspiration behind SEBI's code, is itself open to a number of criticisms.

Boards were primarily chosen by promoters, regardless of the official consultation procedure between the chairman and the promoter or inside the board itself. The vast majority of board members serve at management's request, with the exception of institutional nominees. This implies that most foreign directors on Indian boards are chosen based on preexisting relationships. In addition to suggesting that boards are not chosen through any official selection processes specifically, the type of nominating committees that have been prevalent in the UK since Cadbury this also has consequences for the personalities of the non-executives that serve on Indian boards.

Lack of high-quality professional/non-executive time may reflect the deeper problem of a scarcity of suitably qualified independent directors, and several respondents did say they thought this was a major problem.[1446] With the SEBI Code now mandating specific numbers and proportions of non-executive directors, in the long run managements will presumably have to shift their focus from existing contacts to executive search. However, it is also possible that the problem of an adequate supply is currently exacerbated by the particular model of corporate governance which Indian professional and professionalising managements now largely subscribe to, namely, of the desire to have external directors who can 'add value' to the board and contribute to value-addition by the board.

AUDIT COMMITTEES

Although audit committees are advised by all corporate governance standards, only a small number of nations have made them legally required thus far. Singapore and Canada are the exceptions in this regard. According to the law, audit committees for Canadian public firms must consist of at least three members, the majority of whom must be independent.[1447] In the same manner, the Singapore Companies Act lays forth fundamental specifications for the makeup, functions, and obligations of audit committees.[1448] Nonetheless, in the majority of markets, firms are required by the stock exchange's listing regulations to report their adherence to a code of best practices, which includes the presence of an audit committee. In India, audit committees are now required by both statute and the listing requirements. SEBI's recommendation involves the setting up of audit committees composed only of non-executive directors, of whom the majority are 'independent.' The interesting issue here is whether SEBI's definition of 'independent' is sufficiently tight to make the compositional requirement at all meaningful. It may also be helpful to note at this stage that though the publicly stated aims of the audit committee are to help ensure a high quality of financial reporting, to increase the credibility of audited financial statements, and to protect auditor independence, the academic discussion of their effectiveness has been described as 'limited and inconclusive'.[1449]

Unlike the UK, where the dominant institutional shareholder is an arm's-length investor, in India the domestic financial institutions have always regarded themselves as 'committed' shareholders.[1450] The goal of a strong business lobby is to limit the scope of institutional involvement. The CII's Code of Corporate Governance, which was only eventually

1446 Securities and Exchange Board of India, Disclosure and Investor Protection, SEBI, Issued on Feb 16, 2000.

1447 Companies Act, 1967, §142-158.

1448 Securities and Exchange Board of India, Disclosure and Investor Protection, SEBI, Issued on Feb 16, 2000.

1449 Securities and Exchange Board of India, Disclosure and Investor Protection, SEBI, Issued on Feb 16, 2000.

1450 Khanna and Sushil, Financial Reforms and Industrial Sector in India, (Dec. 14, 2024, 13:39 PM), https://www.jstor.org/stable/4408603.

released in 1998, was the most explicit formal manifestation of this advocacy. Both the CII and the SEBI Codes claim descent from Cadbury, but it is worth noting that their stances on the rights of institutional shareholders depart significantly from Cadbury's.

The failure of the CII Code to gain wider acceptability may well have prompted the regulator to step in and fill the void. SEBI Code came out with a controversial suggestion that 'the financial institutions maintain an arm's length relationship with the company by not seeking a seat on the board of a company' and suggested they would serve the cause of shareholders better by a use of their voting power at the General Body meetings. Later, this was withdrawn in the final version of the law, which only recommended that the institutions should appoint nominees on the boards of companies only on a selective basis where such appointment is pursuant to a right under loan agreements or where such appointment is considered necessary to protect the interest of the institution', and that where institutional directors sit on boards, the nominating institutions should ensure that effective safeguards exist to control the flow of price-sensitive information. SEBI abandoned its earlier stance under institutional pressure, agreeing to leave the matter to their discretion. The new element in SEBI's suggestion, conspicuously missing in the CII Code, is the reference to insider trading.

RECOMMENDATIONS AND FINAL ISSUES

There is now a clear consensus that a substantial reform of governance is necessary in the Indian corporate sector, but much less clarity about the paths along which this should be pursued. Certainly, the most interesting development during this period has been the publication of SEBI's Code of Corporate Governance. The code reflects the pressures from around the world for Indian companies to modernize and expand their financial reporting and disclosure standards, as well as to restructure the governance structure around more powerful and professional boards. However, it can also be interpreted as an effort to give Indian companies some degree of discretion over the kinds of changes they will eventually need to make at all these levels.

Our respondents agreed that non-executive directors have not been effective and have not made enough contributions to the exercise of independent monitoring. Professionals the group that, in theory, most closely resembles the ideal independent director complain about a lack of time, inadequate training, "subconscious" management allegiance, poorly structured agendas, and a fear of complete legal liability. Aside from the broad recommendation that independent directors "devote adequate time for meeting, preparation, and attendance," the SEBI Code makes no mention of any of these matters. A crucial omission relates to the lack of any sort of recommendation for the introduction of nomination committees.

CORPORATE GOVERNANCE OF THE PRIVATE SECTOR: REGULATORY CONCERNS

The public has always been concerned about the standard of corporate governance in the private sector. The stock market fraud of the early 1990s served to highlight the importance of issues of governance, accountability, and transparency.

The Confederation of Indian Industry (CII), the premier representative forum of the Indian private sector, released a code for corporate governance called "Desirable Corporate Governance: A Code" to lessen the harm done to the private sector's reputation during the initial stages of liberalization. At this stage, it would suffice to say that the code envisaged a framework of corporate governance as something that was best left to the consciences of companies, their directors, and their managements and not one that should be enforced through statute. As far as the CII Code sought voluntary compliance by private companies, earlier this year the recommendations of the Securities and Exchange Board of India (SEBI) Committee on Corporate Governance overrode it. SEBI accepted the recommendation of committee that the implementation of certain core aspects of corporate governance should be made mandatory though the amendment of the listing agreements that publicly listed companies enter with stock exchanges.

A minimum of three non-executive board members must be on an audit committee, and most of the committee, including the chairman, must be "independent," according to SEBI regulations. An audit committee of comparable size, with at least two-thirds of its members falling into the non-executive category and one-third of the seats available to executive directors, is suggested by the Companies (Second) Amendment Bill 1999 (CSAB)[1451]. The chairman of the committee may be from either category. According to the codes suggested by the Cadbury Committee and the Blue-Ribbon Committee, audit committees must consist solely of non-executive directors and have most independent directors. The proposed inclusion of audit committee provisions in the CSAB departs from "best practice." In fact, there are suggestions that the United States Securities and Exchange Commission may consider a provision that the terms of audit committee members may be limited to specified ceilings[1452].

CONCLUSIONS

The problem of corporate governance in the Indian private sector companies needs to be understood based on the practices that obtain within the private sector. The issue can be summed up as one group's interests in a firm being prioritized over all others' interests. Unhealthy practices in the private sector have benefited from the inability of regulatory bodies to create a clear set of rules just as much as the private sector has been influential in hampering the implementation of the regulation as it exists. In the case of corporate law there are ambiguities in the law, parallel and often competing regulatory bodies and significant failures even where the law is straightforward. Dual centres of dominance, inconsistent lending and investment policies, and a lack of thorough recovery procedures- even when pushing some of these institutions to the verge of collapse- are also present in the case of development financial institutions. Therefore, a transparent policy-making process that then makes public who is wanting what, rather than one sectoral interest driving public policy, is the primary change that must come before any other.

REFERENCES

- https://www.pwc.com/gx/en/services/audit-assurance/corporate-reporting.html.
- Khanna, Sushil. "Financial Reforms and Industrial Sector in India." *Economic and Political Weekly*, vol. 34, no. 45, 1999, pp. 3231–41. *JSTOR*, http://www.jstor.org/stable/4408603. Accessed 14 Dec. 2024.
- RAY, PARTHA. "Rise and Fall of Industrial Finance in India." *Economic and Political Weekly*, vol. 50, no. 5, 2015, pp. 61–68. *JSTOR*, http://www.jstor.org/stable/24481336. Accessed 14 Dec. 2024.
- https://www.sebi.gov.in/legal/circulars/feb-2000/amendments-to-securities-and-exchange-board-of-india-disclosure-and-investor-protection-guidelines-2000_17936.html.
- Varottil, U. (2018) *Corporate governance in India: The transition from code to statute*, *SSRN*. Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3173591 (Accessed: 14 December 2024).
- Varottil, Umakanth. "Proliferation of corporate governance codes in the backdrop of divergent ownership

[1451] Companies Second Amendment Bill, 1999, Bill No. 13 of 1999, § 134.

[1452] Pricewaterhouse Coopers, Audit Practices: Good Practices for Meeting Market Expectations (Dec. 14, 2024, 14:14 PM), https://www.pwc.com/gx/en/services/audit-assurance/corporate-reporting.html.

structures." *Competition & Change* 24 (2018): 471 - 492.

- *EconPapers: Corporate Governance and the Indian Private Sector*, https://econpapers.repec.org/paper/qehqehwps/qehwps73.htm.