P: ISSN NO.: 2394-0344 RNI No.UPBIL/2016/67980 VOL-3* ISSUE-5* (Part-1) August- 2018
E: ISSN NO.: 2455-0817 *Remarking An Analisation*

Corporate Governance and Board functioning under the Companies Act, 2013:- Concerns, Evaluation and Reflections

Abstract

Good governance in the corporate world has always remained as unfulfilled aspiration for all the stakeholders. Corporate Governance in the corporate world is seen as a character of the company. This dream has been chased by the Government through the policy framework, by the legislature through the statutes, by the stakeholders through rights and remedies and by the society through keeping expectations from corporate administrators. The paper is attempted to show some sensitive concerns with certain inevitable components under the shadow of reasonable evaluation of the provisions of the Companies Act, 2013 and giving reflections on what perspective to be cultivated to bridge the gap between what is and what ought to be within the ambit of a good corporate governance.

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Keywords: Corporate Governance, Companies Act, Directors And Stakeholders.

Introduction

Corporate governance is probably an inevitable part of the larger economic context in which firms operate. The corporate governance framework also depends on the legal, regulatory, and institutional environment. In addition, factors such as business ethics and corporate awareness of the environmental and societal interests of the communities in which it operates can also have an impact on the reputation and the long-term success of a company.One key element in improving economic efficiency is corporate governance, which involves a set of relationships between a company's management and other stakeholders. Corporate governance can be well understood as an approach as well as means to take care of interest of an organization without sacrificing genuine concern and interest of all stakeholders through the means adhere to transparency, equity, fairness and ethics. Corporate governance cannot be ensured simply through stringent provisions contained in any legislation. It is rather more concern with organizational intention and concern for adhering to fair & ethical practice in the decision making and operationalization of decisions taken at the higher level.

In the present day scenario, where apprehension with regards to manipulation, window dressing and financial schemes are increasing, that has increased fear of unknown in the mind of the investors community as a whole. In principle, trust at the beginning to be begged for and given a choice and a chance to be evidenced for. This is possible through enduring efforts guided under the shadow of fair objectives backed up by transparent means and methods. Of course, because of increasing manipulation, a rationale need is felt to have some statutory legislative framework to be provided which leaves minimum room for such corporate nuisance. An incorporated company is a creation of law and coupled with unique privileges of separate legal personality and limited liability. These privileges may do greater harm and damage to the interest of the stakeholders, if adequate statutory framework is not provided by the legislature.

Rationale

Good governance in the corporate world has always remained as unfulfilled aspiration for all the stakeholders. Corporate Governance in the corporate world is seen as a character of the company. This dream has been chased by the Government through the policy framework, by the legislature through the statutes, by the stakeholders through rights and remedies and by the society through keeping expectations from corporate administrators. Thus, this paper “Corporate Governance and Board functioning under the Companies Act, 2013:- Concerns, Evaluation and Reflections” is an attempt to correlate and evaluate components of good governance and the provisions of the Companies Act, 2013.

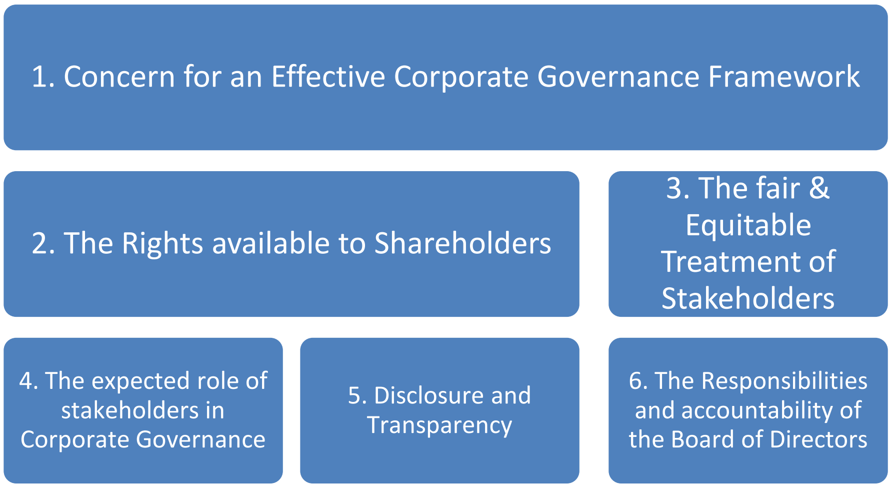
Research Objective and Methodology

The main objective of this paper is to highlight some sensitive concerns with certain inevitable components under the shadow of reasonable evaluation of the provisions of the Companies Act, 2013 and giving reflections on what perspective to be cultivated to bridge the gap between what is and what ought to be within the ambit of a good corporate governance. Considering the identified objective, the research design followed has been essentially descriptive and explorative.

Components of Good Governance Practices

In general following are the major essential components of good governance practices in relation to company as an entity:

Figure 1 Component of Good Governance Practices



Concern for an Effective Corporate Governance Framework

The corporate governance framework should promote transparent and efficient markets, be consistent with legal frame work and should rationally articulate the assignment of responsibilities among different supervisory, regulatory and enforcement authorities. Concern for good governance gets birth out of vision, purpose and mission of an organization. The very reason for emergence, existence and operation of an organization should have ethical touch with deep simphatical and emotional concern for welfare of the stakeholders in general and society as a whole in particular. This leads to shouldering sincere accountability for compliances and respecting not only legal provisions of the statute but expected behavior of an organization as a whole and decision makers in particular, should also covers principles and practices outside the ambit of the statute.

The Rights/Privileges/Remedies available to Shareholders

The corporate governance framework should protect and facilitate the exercise of shareholders’ rights, privileges and remedies as they are promised, specified and understood either through any formal document, relationship or functioning. This includes some fundamentals rights as they are attached with membership in a company of a shareholder like right to get proper notice for a meeting, right to be informed on a periodic and regular basis with regard to major events and developments taking shape in relation to management and operation of a company, right to caste vote, right to get transfer of share by following prescribed procedure, right to participate in appointment of auditors and directors in a company, right to be heard in case of protecting minority interest, right to remove directors by way of dictating concerted voice before expiry of the normal term etc. Some of these rights can be exercised in an individual capacity and some can be availed of in a concerted manner. The operators of a company needs to put efforts to comply with basic and operational documents governing operations of the company and should be extra vigilant with regards to fair & equitable interpretation of the contents of these documents in the best interest of the members.

The fair & Equitable Treatment of Stakeholders

The corporate governance framework should ensure the equitable treatment of all stakeholders, including domestic & foreign shareholders, money lenders, minority shareholders, suppliers, bankers, investors and stock market operators. This component advocates for observing fair compliance and honest practice in relation to dealings, negotiation and association with all the said stakeholders. The company needs to impart reasonable access of information to all stakeholders and thereby providing a fair opportunity and treatment to have rationale evaluation of their existing and perspective association with the company. Within the policy framework, these stakeholders should have the opportunity to obtain effective redress for violation of their rights. This fair treatment may be in the form of having genuine opportunity to have representative on a board, abolishing all possible sources and scope for insider trading in the stock market or to have transparent reporting of data and information and vanishing window dressing from the financial reporting.

The Expected Role of Stakeholders in Corporate Governance

The corporate governance framework should recognize the rights of stakeholders established be law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and sustainability of financially sound enterprises. The rights of stakeholder that are established by law or through mutual agreements are to be respected. Where stakeholder interests are protected by law, stakeholders should have the opportunity to obtain effective redress for violation of their rights. Performance-enhancing mechanisms for employee participation should be permitted to develop. Where stakeholder participates in the corporate governance process, they should have access to relevant, sufficient and reliable information on a timely and regular basis. Stakeholder, including individual employees and their representative bodies, should be able to freely communicate their concerns about illegal or unethical practices to the abroad and their rights should not be compromised for doing this. The corporate governance framework should be complemented by an effective, efficient insolvency framework and by effective enforcement of creditor rights.

Disclosure and Transparency

The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company. It includes the financial and operating results of the company, Remuneration policy for members of the board, Related party transactions, Foreseeable risk factors, Information to be prepared and disclosed in accordance with high quality standards of accounting and financial and non-finance disclosure, auditors remarks and comments. The corporate governance framework should be complemented by an effective approach that addresses and promotes the provision of analysis or advice by analysts, brokers, rating agencies and others, that is relevant to decisions by investors, free from material conflicts of interest that might compromise the integrity of their analysis or advice.

The Responsibilities and accountability of the Board of Directors

The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders. The board should fulfill certain key functions, includes reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans; setting performance objectives; monitoring implementation and corporate performance; and overseeing major capital expenditures, acquisitions and divestitures, monitoring the effectiveness of the company's governance practices and making changes as needed. Selecting, compensating, monitoring and, when necessary, replacing key executives and overseeing succession planning, aligning key executive and board remuneration with the longer term interests of the company and its shareholders, ensuring a formal and transparent board nomination and election process, monitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions, ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for risk management, financial and operational control, and compliance with the law and relevant standards.

Key Changes Introduced by the Companies Act, 2013

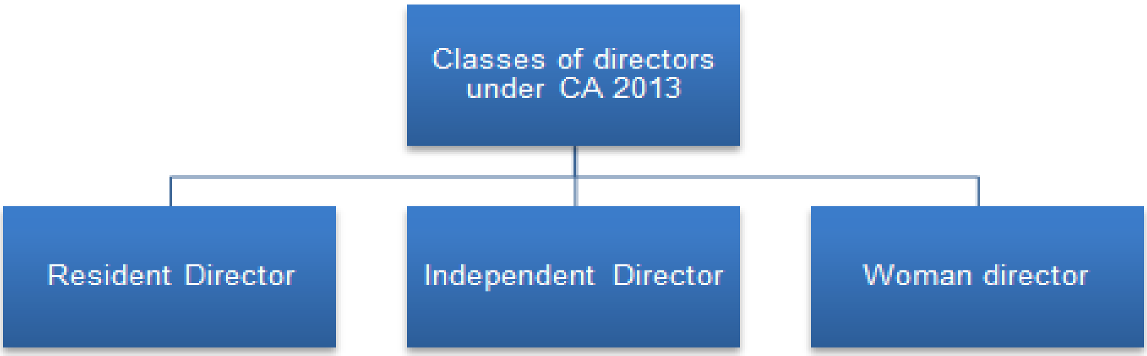
The Government of India has recently notified Companies Act, 2013, which replaces the existing Companies Act, 1956. It is focused herewith to analyze the key changes and their major implications for stakeholders, by concentrating on the practical impact of the changes introduced by the new legislation with respect to management and administration of companies. The changes in law are aimed at ensuring higher standards of transparency and accountability, and seek to ensure the corporate governance practices in India with global best practices. Companies Act, 2013 has introduced drastic change in the composition, functioning and operations of the board of directors of a company. The key changes introduced are as under:

Number of Directors

A one person company shall have a minimum of 1 (one) director. Companies Act, 1956 permitted a company to determine the maximum number of directors on its board by way of its articles of association (reference to section 258 & 259) Companies Act, 2013, however, specifically provides that a company may have a maximum of 15 (fifteen) directors. Companies Act,1956 required public companies to obtain Central Government's approval for increasing the number of its directors above the limit prescribed in its articles or if such increase would lead to the total number of directors on the board exceeding 12 (twelve) directors. Companies Act 2013 however, permits every company to appoint directors above the prescribed limit of 15 (fifteen) by authorizing such increase through a special resolution. This change leads to greater flexibility to the companies in composition of the board.

Companies Act 2013 requires companies to have the following classes of directors' viz., Resident Director, Independent Director and Woman Director.

Figure 2 Classes of Directors' under Companies Act 2013



Resident Director

Companies Act 2013 introduces the requirement of appointing a resident director, i.e., a person who has stayed in India for a total period of not less than 182 (one hundred and eighty two) days in the previous calendar year. This change leads to abolish possibility of appointment of non-resident person as a director of a company which will have greater positive impact on functioning of directors in a board in term of discharging their duties and liabilities.

Independent Directors

Companies Act 1956 had no provision for mandatory appointment of an independent director on the board of companies. This requirement was at the discretion of the condition mentioned in the Listing Agreement as set out in Clause 49.

Number of Independent Directors

As per the Listing Agreement, only listed companies were required to appoint independent directors. The number of independent directors on the board of a listed company was required to be equal to (a) one third of the board, where the chairman of the board is a non-executive director; or (b) one half of the board, where the chairman is an executive director.

However, under companies 2013, the companies are required to appoint independent directors are: (a) *Public listed company, wherein at least one third of the board comprise of an independent director* and(b) Certain specified companies that meet the pecuniary criteria are required to have at least 2 (two) independent directors, as mention in the new legislation.

Qualification Criteria

Companies Act, 2013 prescribes detailed qualifications for the appointment of an independent director on the board of a company. These qualifications include:

1. he / she should be a person of integrity, relevant expertise and experience;
2. he / she is not or was not a promoter of, or related to the promoter or director of the company or its holding, subsidiary or associate company;
3. he / she has or had no pecuniary relationship with the company, its holding, subsidiary or associate company, or their promoters, or directors during the 2 (two) immediately preceding financial years or during the current financial year;
4. a person, none of whose relatives have or had pecuniary relationship or transaction with the company, its holding, subsidiary or associate company, or their promoters, or directors amounting to 2 (two) percent or more of its gross turnover or total income or INR 5,000,000 (Rupees five million only), whichever is lower, during the 2 (two) immediately preceding financial years or during the current financial year.

The companies Act, 1956 was containing no specific explanation related to qualification of director was prescribed for except he or she has to be an 'individual' (section 253) and certain abnormal incidences where described as 'disqualification to act as a director' (section 274). It is evident from provisions of Companies Act, 2013 that much emphasis has been placed on skill, talent, integrity, expertise and experience in a person who is to be appointed as a director, with special care not to leave any scope for such appointment of a candidate who has pecuniary and vested interest in a company. This change has ensure automatic compliance of the previous provision as where contain in section 299 & 300 related with 'disclosure of interest by a director' read together with section 283 concern with compulsory vacation in the office of a director.

Duties of Independent Directors

Neither the Listing Agreement nor the Companies Act 1956 specified duties to be discharged by an independent director. Companies Act 2013 includes a guide to professional conduct for independent directors, which crystallizes the role of independent directors by prescribing facilitative roles, such as offering independent judgment on issues of strategy, performance and key appointments, and taking an objective view on performance evaluation of the board. Independent directors are additionally required to satisfy themselves on the integrity of financial information, to balance the conflicting interests of all stakeholders and, in particular, to protect the rights of the minority shareholders. The SEBI Circular however, states that the board is required to lay down a code of conduct which would incorporate the duties of independent directors as set out in Companies Act, 2013.

The new legislation has not simply casted specific duties on an independent director, but also prescribed scope to caste liability for not discharging role with prudence and due diligence even after performing duties casted specifically on them by the legislation. This will bring extra vigilant approach and involvement with commitment by an independent director in overall administration of a company.

Liability of Independent Directors

Under Companies Act 1956, independent directors were not considered to be “officers in default” (reference to section 5) and consequently were not liable for the actions of the board. Companies Act, 2013 however, provides that the liability of independent directors would be limited to acts of omission or commission by a company which occurred with their knowledge, attributable through board processes, and with their consent and connivance or where they have not acted diligently.

Companies Act, 2013 proposes to empower independent directors with a view to increase accountability and transparency. It has tried to hold independent directors liable for acts or omissions or commission committed by a company which has occurred within knowledge of an independent director and attributable through board processes. This change is introduced with an intention to increase accountability in the board & has enriched the role of an independent director. However it will always remained apprehending to its real intended application since independent directors are vested with less power and blanketed with general liability for omissions or commissions committed by the board as a specific body.

Woman Director

Listed companies and certain other public companies shall be required to appoint at least 1 (one) woman director on its board. Companies incorporated under Companies Act 2013 shall be required to comply with this provision within 6 (six) months from date of incorporation. In case of companies incorporated under Companies Act 1956, companies are required to comply with the provision within a period of 1 (one) year from the commencement of the act.

Suggestions

1. Increase importance should be given to the appointment of Independent Director and Lead Independent Director
2. Chairman position should be occupied by the Independent director only.
3. Auditors should also be independent and there should be dual auditing that must take place and at both place auditing should be done by independent auditors, i.e. to have one more Independent Auditor working above the existing Independent Auditor.
4. The board should comprise of skilled, educated, highly literate people.
5. The rotation period of Auditors should be less than three years.
6. Board should recognize the basic fact that good governance is not just about compliance.
7. Providing shareholders with necessary information from time to time to ensure that their interest is protected.
8. Involving the minority shareholders in the decision making and importance should be given towards protection of their rights.
9. Companies should focus on ethical practices and should work on the principles which will improve the company’s performance and will also build up the trust of the stakeholders.
10. The companies should make all the disclosures as required to build up the trust of foreign investors which attract more foreign investment into the country and will boost up the Indian Economy.

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