Corporate Governance in Listed Companies

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Status Quo

Effective corporate governance norms in listed companies have always had an added significance in assessing levels of compliance for corporates, given the diverse nature of the stakeholders that have interests in such listed companies. Companies need to ensure the interests of all their stakeholders and should look beyond just their shareholders. The stakeholders are all the parties that are concerned with how a company is being run and include the employees, the creditors, the company's customers, its suppliers, and even the regulator – who has been entrusted with the responsibility of ensuring that all corporates under its watch toe the line.

Corporate governance is crucial as it is intended to establish a system of accountability within companies. The Securities and Exchange Board of India (SEBI), has always endeavoured to work towards its primary duty to protect the interests of investors in securities and in parallel, to promote as well as to regulate the development of the securities market. SEBI has given weightage to the role of corporate governance in maintaining the balance of interests in the securities market, from the days of the Kumar Mangalam Birla committee.

In recent times, SEBI has sought to reform corporate governance norms and align the board processes and disclosure norms applicable to listed companies with the Companies Act, 2013. SEBI issued a 'Consultative Paper on Review of Corporate Governance Norms in India' in 2013 and followed it up by enhancing the corporate governance practices applicable to listed companies in relation to independent directors, related party transactions, remuneration policies, compulsory whistle blower mechanism and role of the board and other committees.

However, this has not been entirely successful in addressing corporate governance issues faced by corporates. It can be largely attributed to a fallout of badly practiced corporate governance norms. It has also stirred SEBI into considering a re-look at the governance norms, leading to SEBI constituting a committee headed by Uday Kotak. The Kotak Committee has been formed to advise on issues relating to corporate governance in Indian firms. It has been reported that the Kotak committee has been mandated to focus on areas ensuring "active participation of independent directors, improving safeguards and disclosures pertaining to related party transactions, issues in accounting and auditing practices, improving effectiveness of board evaluation practices, addressing issues faced by investors on voting and participating in general meetings and transparency related policies".

Board's crucial role

The historical problem in the functioning of the board has been its inability to disassociate with the expectation of functioning as shareholders' representatives. This implies that the management of a company is eventually run on the instructions of shareholders, as opposed to the individuals nominated for the job. This presents a problem on multiple levels. First, given that India still has many predominantly family held or closely held companies (listed or otherwise), the board becomes an operational instrument of the voice of the majority shareholder. This results in the focus shifting to 'controlling rights' rather than ownership of the body corporate. The rights of the minority shareholders, which the law and the regulator are under equal duty to protect, take a backseat, sometimes even unintentionally.

Second, the board's fiduciary duty to the company and to each shareholder diminishes before the importance assigned to 'corporate democracy'. As a result, the distinction between the ownership directing the company towards higher returns and the board and management looking out for the holistic progress of the company blurs. However, the latter is what needs to be the prime focus of the board. To ensure this, adequate and varied representation needs to be an essential element in the composition of any board. Independent directors should not be made to bear this burden alone.

Although statutory steps have been taken in this regard, an environment of mere namesake representation still dominates corporates. The need of this hour is to ensure that a conducive atmosphere to facilitate comprehensive decision making by the board by paying attention to opinions from all quarters is allowed.

Evaluation of Board's Performance

Performance evaluation is a key tool in corporate governance. It enables the board to assess and scrutinise its own role, its contribution towards good governance practices, its shortcomings and it can assist in charting the future course. Additionally, it restores confidence in stakeholders as to the board taking its duty and its performance seriously. One of the primary goals of board evaluation is for the board to identify its barriers, to eliminate components adding to such barriers and to determine ways to fortify its means to overcome such barriers. An evaluation done in the right manner, can benefit the board on an organisation level, board level as well as at an individual level.

Although the Companies Act 2013 and SEBI's Regulations on Listing Obligations and Disclosure Requirements (LODR) contain provisions on board evaluation, it is yet to be implemented in true spirit, by several corporates, as has been noted by SEBI in its circular issued in January 2017 enclosing a 'Guidance Note on Board Evaluation'.

In the guidance note, SEBI elaborated the process of evaluation, laying down means to identify objectives, criteria and method of evaluation and allowed companies to look at set of principles for board evaluation. However, the statutory provisions or the SEBI guidance note do not stress on the results of such performance evaluation. The current statutory provisions require disclosure of the manner of evaluation of the board, its committees and individual directors and of performance evaluation criteria. Although the guidance note mentions in passing that several corporates world-wide voluntarily disclose the results of such performance and the actions taken basis the results, it is not recommended by SEBI as a guiding principle for Indian companies. Given the perpetual emphasis on greater transparency for successful corporate governance, it is not enough to conduct evaluations, if stakeholders are not made aware of what such evaluations result in. If the outcome of such evaluations is not disclosed, then it does little to generate assurance and may lead to the point of such evaluation processes being largely lost.

Independent Directors – Too many expectations?

Since the introduction of independent directors as a crucial element on the boards of companies, all sorts of measures have been considered to make the independent directors more involved in the functioning of the companies and to make their standards more and more impeccable. The terms and conditions for the appointment and functioning of the independent directors are included in detail in the Companies Act 2013. It specifically covers the criteria of eligibility, expected time commitment, their roles and responsibilities, applicable code of conduct, liability for not acting diligently, maximum remuneration and obligations of confidentiality and non-disclosure. In a bid to ensure that the independent directors feel justly rewarded for their services, and to inspire greater commitment and responsibility from such independent directors, the Companies (Amendment) Bill, 2016 is also seeking to enhance the pecuniary interest of independent directors up to 10% in companies.

This level of responsibility seems disproportionate to be borne by independent directors who, in practice, end up attending a few board meetings annually. Independent directors are not steeped in knowledge of the company's sector, unlike its management. It is difficult for them to evaluate the board and the management in their business decisions and to direct the affairs of a company in a way.

The independent director may be able to evaluate the compliance levels of the company and regulate actions that may be detrimental to the interests of shareholders, only with due co-operation from the board, the management and the shareholders themselves. In effect, the resources available to an independent director in running the company may not be very different from that of a director nominated by financial investors. Unfortunately for independent directors, unlike such nominee directors, independent directors do not enjoy the backing of shareholders. It may be necessary to hear the views of independent directors themselves with respect to the good and the bad of their prescribed roles, before going about any further reforms.

Independent Directors - Balance of Powers against Responsibilities

Keeping in mind the duties of an independent director, which are considered the core of corporate governance, it becomes necessary to analyse the powers given to independent directors to be able to discharge their duties efficiently. At the heart of the independent director's role, lies the ability to keep challenging and providing a critical opinion on the acts and decisions of the rest of the board. This is to ensure that there is an effective check on the board, which does not become driven purely by the interests of the dominating shareholder. However, if one looks to the law for assessing the immunity given to such independent directors for taking on this daunting task, one will realise that such independent directors hold office during the pleasure of the shareholders. Like all other directors, independent directors can be removed by the shareholders if such resolution to remove receives support of shareholders holding more than 51% of the voting power in the company. These are highly lessened standards compared to those that independent directors are required to adhere to for their appointment. SEBI has very recently begun to take cognizance of this imbalance and is seeking to make the removal of independent directors a more stringent exercise, owing to certain negative repercussions of the shareholders' power that have materialised quite publicly.

Another issue related to independent directors is the evaluation process. By law, the evaluation of the performance of independent directors is required to be done by the rest of the board. This is a circular process because as an independent director, one's role would be to question continuously and critically examine the acts of the board, which at the end of the year sits in judgement of the independent directors themselves! This would potentially negate and impede any confidence or freedom that the independent director may have in discharging his/her duties. Given that the law has no provision to mandatorily require disclosure of results of performance evaluation, this gives the scope to the board to dilute the role of the independent director to a large extent.

Conclusion – Overarching Role of the Regulator

In conclusion, it is essential to dedicate some space to reflect on the role of SEBI. Although SEBI has made corporate governance its crusade, it has been difficult to single out its role in regulating the emerging era of corporate run communities. As a regulator, its main role should be to look after implementation of the numerous laws, regulations and guidelines that companies have been mandated to adhere to and to weed out instances of non-compliances.

The never-ending emphasis on transparency and disclosures has not been enough to stop an 'Enron' or a 'Satyam' or the newer slew of corporate governance failures that have recently surfaced. One cannot help but wonder as to what happens to these disclosures once they are made. Which stakeholder is taking cognizance of the cracks in corporate governance that start showing early on? SEBI needs to wear its mantle of the market regulator more often than a policy maker, in the interests of all those who it seeks to protect. A more proactive, as opposed to a reactive, role needs to be performed by SEBI, if the market and all its participants are to be shielded from the blows of an impending debacle in the corporate world.

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