

# Whistle-Blowing Mechanisms for Private Companies: A Need for the Gatekeepers of Corporate Governance



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India Inc. has in the past few decades seen significant jumps in economic activity (on the back of liberalization of the economy) and has attracted and continues to attract investments from within the country and from overseas. Oft repeated is the projection of India becoming a \$5 trillion economy by the end of the decade. While the economists watch and predict the growth track of this emerging economic superpower, it also behooves us to take stock of where we stand in terms of the essential tenets of corporate governance of transparency, accountability, and investor protection-to ensure that this growth is a sustainable one and brings the promised rewards to all the stakeholders and not just a handful.

In the last decade, several legal reforms were introduced to enhance the culture of governance for companies. One such important mechanism is a platform for “whistle-blowing” as it gives a platform to the insiders of a company to report issues of ethics, misconduct, and illegality in the functioning of the organization in an ‘anonymous’ manner to senior officials within the company who are expected to handle such complaints with the necessary impartiality and diligence. However, despite the importance of whistleblowing in the culture and governance of the corporation, Indian company law currently mandates the “vigil mechanism” to be incorporated by only listed companies and other limited types of companies with certain financial obligations to the public (through bank borrowings above INR 50 crore or through deposits from the public). This vigil mechanism is to be a platform for directors and employees of the company to report ‘genuine concerns’ (‘genuine concerns’ being quite an all-encompassing phrase). The vigil mechanism is to be overseen by the audit committee in cases where the company is required under law to constitute an audit committee (independent directors are required to constitute a majority in audit committees). In companies that are not required to constitute an audit committee, the vigil mechanism is to be overseen by a director nominated by the board. The vigil mechanism is to also provide for adequate safeguards against victimization. Further in the case of frivolous complaints, the audit committee or the director overseeing the vigil mechanism can take suitable actions including reprimanding the concerned employee. Currently, therefore Indian law has not forayed into mandating whistle-blower mechanisms in private companies that do not meet the financial obligations’ threshold mentioned above (a threshold which is not very easily crossed for most private companies). India’s only whistle-blowing focussed legislation - the much-awaited Whistle Blowers Protection Act, which is yet to be brought in force, limits itself to whistleblowing only against public servants. As a result, the institution of whistleblowing mechanisms for private companies, is largely driven by individual corporate policies of an organisation. In the absence of such law-mandated mechanisms in private companies, employees and insiders will find the already daunting task of whistle-blowing a near impossibility. In fact, having a whistle-blowing mechanism is just a ‘first-step’ for such platforms of good governance to function meaningfully - hand-in-hand needs to go awareness and sensitization of employees through training on ethics and corruption, on the rights and obligations of an employee, assurance against retaliation, etc. Therefore, certainly glaring in its absence is a law driven mandate for whistle-blowing mechanism in private companies.

Broadly speaking, in India, private companies can be seen as belonging to two categories - subsidiaries of foreign parents which are part of a larger multinational group, and Indian family owned and run companies. Most often for the former category, owing to the push of anti-corruption laws from the home jurisdiction of the parent company (like

the Foreign Corrupt Practises Act, 1977 in the United States, the UK Bribery Act in United Kingdom), whistle-blower frameworks are rolled out globally across all jurisdictions in which business is done (including in India). The absence of such mechanisms becomes pronounced in the latter category of Indian private companies (entirely family owned and run). Whistle-blowing mechanisms is one of the important cogs of a larger corporate governance machinery that goes towards building ethically, and in the long-term sustainably run businesses. The importance of this is not diminished in any manner for family-run private companies either. These mechanisms play the important role in catching ‘cracks’ and ‘faults’ in the systems early on, through issues relating to larger ethics and culture of an organisation, before it translates into tangible loss of profits, business, and reputation for an organisation. An added issue in such family-run private companies is the conflation of the identity of the promoter family owning (and most often running the business) with the identity of the company itself (unlike larger companies where ownership and management are not concentrated in the same hands) – resulting in conflicts of interest when it comes to addressing allegations involving the running of the affairs of the company. In such situations, equally important is the need for impartial and non-conflicted response mechanisms to whistle-blower complaints (for instance involving impartial third-party investigators) in looking into the veracity of the complaints raised.

Apart from the larger public interest of having a business environment that supports ethics and good governance, more direct questions of public interest come in when such private companies are recipient of loans from publicly owned banks (company law recognises this in a way by requiring that companies that have borrowed money from banks and public financial institutions in excess of INR fifty crore will be required to have a vigil mechanism in place). With the growing importance globally of the pillars of Environment Social Governance (ESG) philosophy in running corporations, the importance of building stronger corporate governance mechanisms cannot be emphasised enough, as “profit maximisation” is no longer the sole criteria in evaluating the success of corporate enterprises – and private companies are no exception to this. Important to bear in mind is that a company being privately held and run, should not make it any less responsible for having robust corporate governance mechanisms – in taking a cross-section of the larger business environment in India, private companies in terms of their number and quantum of business activities will very likely exceed public companies. Most of the start-ups for instance are private companies, and these are entities bringing tectonic shifts to the Indian business environment through their break-through products and business models. To elaborate this point further, we can take some guidance from the duties of directors codified under Section 166 of the Companies Act to include the following -“...act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the *best interests of the company, its employees, the shareholders, the community* (emphasis supplied)...”; “...exercise his duties with due and reasonable *care, skill and diligence and shall exercise independent judgment* (emphasis supplied) ...”; “...shall not involve in a situation in which he may have a direct or indirect interest that conflicts, or possibly may *conflict, with the interest of the company* (emphasis supplied) ...”. From these provisions can be culled the spirit of the good governance for the larger interests of society and the community, which are agnostic to whether a company is private or public. Realising these larger goals will need specific mechanisms like law driven whistle-blower mechanisms to ensure that deviations don’t go undetected even in close knit private companies. The Securities Exchange Board of India (India’s capital markets regulator) recently made a commendable move in incentivizing whistle blowing for cases of insider trading, by announcing a maximum reward of up to INR 10 crores. Taking a cue from this, changes in company law should be brought about to promote and incentivize whistle-blowing in the larger corporate landscape to give all the insiders and daily participants of running a business (irrespective of whether it is a private or a public company), a safe platform to identify and voice concerns on ‘cracks’ in the wall before the fault-lines spread to affecting the very foundation of the business.

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