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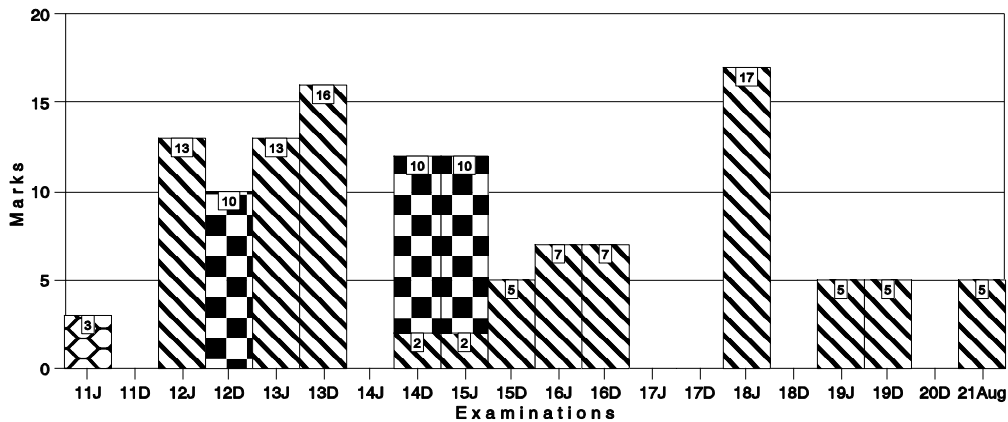
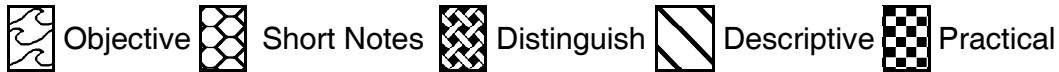
CONCEPTUAL FRAMEWORK OF CORPORATE GOVERNANCE

THIS CHAPTER INCLUDES

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| <ul style="list-style-type: none"> • Introduction • Definitions • Need for Corporate Governance • Elements of Good Corporate Governance • Corporate Governance Theories • Evolution of Corporate Governance • Corporate Governance in Major Jurisdictions <ul style="list-style-type: none"> • South Africa | <ul style="list-style-type: none"> • OECD Principles of Corporate Governance • Australia • Singapore • Management vs. Ownership • Majority vs. Minority • Corporate Governance in Indian ethos • Corporate Governance and Family Enterprises |
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Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions

Legend



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CHAPTER AT A GLANCE**Corporate Governance**

“Corporate Governance is about promoting corporate fairness, transparency and accountability”.

Agency Theory

According to this theory, managers act as 'Agents' of the corporation. The owners set the central objectives of the corporation. Managers are responsible for carrying out these objectives in day-to-day work of the company. Corporate Governance is control of management through designing the structures and processes.

Stakeholder Theory

According to this theory, the company is seen as an input-output model and all the interest groups which include creditors, employees, customers, suppliers, local-community and the government are to be considered. From their point of view, a corporation exists for them and not the shareholders alone.

Raksha

Literally means protection, in the corporate scenario it can be equated with the risk management aspect.

Vridhhi

Literally means growth, in the present day context can be equated to stakeholder value enhancement.

Palana

Literally means maintenance/compliance, in the present day context it can be equated to compliance to the law in letter and spirit.

Yogakshema

Literally means well being and in Kautilya's Arthashastra it is used in context of a social security system. In the present day context it can be equated to corporate social responsibility.

Triple Bottom Line

Is an accounting framework with three parts: social, environmental and financial. Organizations have adopted the TBL framework to evaluate their performance in a broader perspective to create greater business value.

Non-executive Director

A member of a company's board of directors who is not part of the executive team.

A non-executive director typically does not engage in the day-to-day management of the organization, but is involved in policymaking and planning exercises.

Structure of the Principles and Recommendations

1. Lay solid foundations for management and oversight
2. Structure the board to add value
3. Act ethically and responsibly
4. Safeguard integrity in corporate reporting
5. Make timely and balanced disclosure
6. Respect the rights of security holders
7. Recognise and manage risk
8. Remunerate fairly and responsibly

SHORT NOTES

2009 - Dec [2] (a) Write short notes on the following :

- (i) Rules vs. principles
- (ii) Parties to corporate governance. **(3 marks each)**

Answer:

(i) Rule Vs. Principles:

Rules are written prescriptions for conduct or action and are absolute. Principles, on the other hand, provides a guidance of acceptable action that are fair and equitable.

Under rules-based governance, companies must comply with a specific set of procedural requirements a check list of what to do and what not to do. Under a principles based regime, however, corporate behaviour is guided by a focus on end results. This approach emphasize “doing the right thing” by whatever means the company’s leadership feels most appropriate.

Rules are typically thought to be simpler to follow than principles, demarcating a clear line between acceptable and unacceptable behaviour. Rules also reduces discretion on the part of the individual manager or auditors.

Hon’ble Supreme Court of India in a case of Bajaj Auto Limited defined the discretion as proper adoption of the rules.

In practice rules can be more complex than principles. They may be ill equipped to deal with new types of transactions not covered by the code.

Moreover, where clear rules are followed one can still find a way to circumvent their underlying purpose. This is harder to achieve if one is bound by broader principles.

Principles are a form of self regulation. They allow the respective sector to determine what standards are acceptable or unacceptable. It also preempts over zealous legislations that might not be practical.

(ii) Parties to Corporate Governance:

The Board of Directors play a central role in ensuring good governance in a corporate. In a business context, Those who have a “stake” or claim in some aspect of a company’s products, operations, markets, industry and outcomes are known as stakeholders. The various stakeholders of a corporate are all parties to corporate governance. The stakeholders of a corporate include its employees, shareholders, suppliers, vendors, customers, creditors, regulators, governments and the community at large. These groups are influenced by business, and they also have the ability to affect the business.

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2010 - June [2] (a) Write a note on the following:

(iii) The Greenbury Report.

(5 marks)

Answer :

The Greenbury Report (1995) : The Confederation of British Industry set up a group under the chairmanship of Sir Richard Greenbury to examine the remuneration of the directors. It recommended the formation of remuneration committee composed of non-executive directors. Its recommendations were incorporated in the Listing Rules of the London Stock Exchange.

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2010 - Dec [2] (a) Write short notes on the following :

(i) The Turnbull Report

(3 marks)

(ii) CII’s Desirable Corporate Governance Code

(3 marks)

Answer :

(i) The Turnbull Report :

A working group under the Chairmanship of Nigel Turnbull recommended the internal control guidance for Directors which were included in the combined code.

In 2004, the financial Reporting Council established the Turnbull Review Group to consider the impact of the guidance and the related disclosures and to determine whether the guidance needed to be updated. In October, 2005 the revised guidance was issued.

(ii) CII's Desirable Corporate Governance Code:

Confederation of Indian Industry (CII) took a special initiative on corporate Governance, the first institution initiative in Indian Industry. The objective was to develop and promote a code of Corporate Governance to be adopted and followed by Indian Companies. The final draft of the said code was widely circulated in 1997. In April, 1998 the code was released. It was called Desirable Corporate Governance Code.

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2011 - June [2] (a) Write short note on the following :

(iii) Task force on corporate excellence through governance **(3 marks)**

Answer :

In May 2000, a task force on Corporate Excellence setup by the group under the chairmanship of Dr. P. L. Sanjeev Reddy, Secretary, DCA (Now MCA) produced a report containing a range of recommendations for raising governance standards among all companies in India. The group examined ways to “operationalise the concept of corporate excellence on a sustained basis”, so as to “sharpen India’s global competitive edge and to further develop corporate culture in the country”.

A summary report of Task Force:

- (i) Higher delineation of independence criteria and minimisation of interest-conflict potential.
- (ii) Directorial commitment and accountability through fewer and more focused board and committee membership.
- (iii) Meaningful and transparent accounting and reporting, improved annual report along with more detailed filing with regulatory authorities.
- (iv) Setting up of an independent, Autonomous Centre for Corporate Excellence to accord accreditation and promote policy research and studies, training and education, etc, in the field of corporate excellence through improved corporate governance.
- (v) Introducing formal recognition of Corporate Social Responsibility.

- (vi) Clear distinction between two basic components of governance in terms of policy making and oversight responsibilities of the board of directors.
- (vii) Apply the highest and toughest standards of corporate governance to Listed Companies.
- (viii) PSUs be relieved from multiple surveillance agencies and simultaneously a commission be appointed to draft a suitable code of public behaviour.

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DESCRIPTIVE QUESTIONS

2009 - June [1] {C} (a) On 8th February, 2009, The Hindustan Times published a news caption “Crisis of unimaginable proportions – Fraud @ Satyam. Company running out of cash to pay salaries – faces lawsuits.” It further remarked : “The country is rocked by possibly the biggest corporate fraud. The company's profits and cash reserves had been doctored for several years with possible connivance of auditors.” Obviously, the company had committed breach of good governance practices and legal bulwarks.

If you have to investigate into this case, which aspects of Corporate Governance would you look into ? **(10 marks)**

Answer :

One of the most appropriate definition of Corporate Governance (CG) has been given by ICSI, i.e. Corporate Governance is the application of best management practices, Compliance of law in true letter and spirit and adherence to ethical standards for effective management and distribution of wealth and discharge of social responsibility for sustained development of all stakeholders. Its principles are:

1. Sustained development of all stakeholders.
2. Effective management and distribution of wealth.
3. Discharge of social responsibility.
4. Application of best management practices.
5. Compliance with law in letter and spirit.
6. Adherence to ethical standards.

Satyam failed fundamentally on counts of integrity, probity and ethics. The very intent of the promoter directors was to siphon-off the funds of the company to fuel their insatiable greed to amass wealth.

The accounts of Satyam did not reflect true and fair views of the state of affairs of the Company. The auditors, after the confession by the managing director, stated that the accounts of Satyam could not be relied upon.

On the face of it Satyam was a compliant company but the intent of the promoter directors was to defraud. Some of the issues that should be investigated in the Satyam case include:

- (i) Transaction with related parties.
- (ii) Violation of SEBI (Substantial Acquisition of Shares and Takeover) Regulations;
- (iii) Violation of SEBI (Prohibition of Insider Trading) Regulation.
- (iv) The nature of information placed before the Board and the Audit Committee.
- (v) The role of the internal auditors.
- (vi) The role of the statutory auditors.
- (vii) The role of the Chief Financial Officer.
- (viii) The role of the Company Secretary.

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2009 - Dec [4] (b) Discuss briefly the role of directors in the good corporate governance. **(5 marks)**

Answer :

The Board of directors play an important role in ensuring good governance. The contribution of directors on the Board is critical to the way a corporate conduct itself. The responsibilities of the directors and the Board derive from law, custom, tradition and current practice. In the present times, transparency, disclosure, accountability, issues of sustainability, corporate citizenship, globalization are some of the concern that the Board interlocks. The Boards today have to respond to the explosive demands of the marketplace. The contribution of directors on the Board of Companies is critical for ensuring appropriate directions with regard to leadership, vision strategy, policies, monitoring , supervision, accountability to shareholders

and other stakeholders and in achieving greater level of performance on a sustained basis as well as adherence to the best practice of corporate governance.

Directors have the ultimate responsibility for the long- term prosperity of the company. They are required in law to apply skill and care in exercising their duty to the company and are subject to fiduciary duties. If they are in breach of their duties or act improperly, directors may be made personally liable in both civil and criminal law.

Directors are accountable to the shareholders for the company's performance and can be removed from office by them or the shareholders can pass a special resolution requiring the directors to act in a particular way. Directors act as 'Fiduciaries' of the shareholders and should act in their best interests but also taking into account the best interests of the company as a whole (as a separate legal entity) and the other stakeholders.

Directors have a key role in the determination of the value and ethical position of the company.

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2012 - June [1] {C} (a) "Corporate governance extends beyond corporate law. Its fundamental objective is not mere fulfilment of the requirements of law, but in ensuring commitment of the Board of directors in managing the company in a transparent manner for maximising stakeholders' value". In the light of this statement, discuss the various factors which add greater value through good governance. **(10 marks)**

Answer :

The Statement is true. The various factors which add greater value through good governance are:

- (1) **Corporate Performance:** Improved governance structure and processes help ensure quality decision making, encourage effective succession planning for senior management and enhance the long- term prosperity of companies, independent of the type of company and its sources of finance. This can be linked with improved corporate performance either in terms of share price or profitability.

- (2) **Better Access to Global Market:** Good Corporate Governance system attracts investment from global investors, which subsequently leads to greater efficiencies in the financial sector.
- (3) **Enhanced Investor Trust:** Investors consider Corporate Governance as important as financial performance while evaluating companies for investment. Investors who are provided with high levels of disclosure and transparency are likely to invest openly in those companies.
- (4) **Enhancing Enterprise Valuation:** Improved management accountability and operational transparency fulfill investor's expectations and confidence on management and corporations and return, increase the value of corporations.
- (5) **Combating Corruption:** Corporate Governance enables a corporation to compete more efficiently and prevent fraud and *malpractices* within the organization.
- (6) **Easy Finance from Institutions:** Several structural changes like increased role of financial intermediaries and institutional investors, size of the enterprises, investment choices available to investors, increased competition, and increased risk exposure have made monitoring the use of capital more complex thereby increasing the need of Good Corporate Governance, Evidence indicates that well. Governed Companies receive higher market valuations.
- (7) **Reduced risk of Corporate Crisis and Scandals:** Effective Corporate Governance ensure efficient risk mitigation system in place.
- (8) **Accountability:** Good Corporate Governance practices create the environment where Boards cannot ignore their accountability to these stakeholders.

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2012 - June [4] (b) Discuss briefly the following:

- (i) Evidence of Corporate Governance from Arthashastra

(3 marks)

Answer:**Evidence of Corporate Governance from Arthashastra**

Kautilya's Arthashastra maintains that for good governance, all administrators, including the king were considered servants of the people. Good governance and stability were completely linked. Kautilya elaborates on the four fold duty of a king as:

1. **Raksha:** literally means protection, in the corporate scenario it can be equated with the risk management aspect.
2. **Vridhhi:** literally means growth in the present day context can be equated to stakeholder value enhancement.
3. **Palana:** literally means maintenance/compliance, in the present day context it can be equated to compliance of the law in letter and spirit.
4. **Yogakshema:** literally means well being and in Kautilya's Arthashastra it is used in context of a social security system. In the present day context it can be equated to corporate social responsibility.

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2013 - June [1] {C} (a) "Good corporates are not born, but are made by the combined efforts of all stakeholders, board of directors, government and the society at large." In the light of this statement, bring out the elements of good Corporate Governance in India. **(10 marks)**

Answer:**Elements of Good Corporate Governance**

Some of the important elements of good corporate governance are discussed as under:

1. Role and Powers of Board

Good governance is decisively the manifestation of personal beliefs and values which configure the organizational values, beliefs and actions of its Board. The Board as a main functionary is primary responsible to ensure value creation for its stakeholders.

2. Legislation

Clear and unambiguous legislation and regulations are fundamental to effective corporate governance.

3. Management environment

Management environment includes setting-up of clear objectives and appropriate ethical framework, establishing due processes, providing for transparency and clear enunciation of responsibility and accountability, implementing sound business planning, encouraging business risk assessment, having right people and right skill for the jobs, establishing clear boundaries for acceptable behaviour, establishing performance evaluation measures and evaluating performance and sufficiently recognizing individual and group contribution.

4. Board skills

A Board should have a mix of the following skills, knowledge and experience:

- (i) Operational or technical expertise, commitment to establish leadership;
- (ii) Financial skills;
- (iii) Legal skills; and
- (iv) Knowledge of Government and regulatory requirement.

5. Board appointments

To ensure that the most competent people are appointed in the Board, the Board positions should be filled through the process of extensive search.

6. Board induction and training

Directors must have a broad understanding of the area of operation of the company's business, corporate strategy and challenges being faced by the Board.

7. Board independence

Independent Board is essential for sound corporate governance. This goal may be achieved by associating sufficient number of independent directors with the Board.

8. Board meetings

Directors must devote sufficient time and give due attention to meet their obligations. Attending Board Meetings regularly and preparing thoroughly before entering the Boardroom increases the quality of interaction at Board Meetings.

9. Code of conduct

It is essential that the organization's explicitly prescribed norms of ethical practices and code of conduct are communicated to all stakeholders and are clearly understood and followed by each member of the organization.

10. Strategy setting

The objectives of the company must be clearly documented in a long-term corporate strategy including an annual business plan together with achievable and measurable performance targets and milestones.

11. Business and community obligations

Though basic activity of a business entity is inherently commercial yet it must also take care of community's obligations.

12. Financial and operational reporting

The Board requires comprehensive, regular, reliable, timely, correct and relevant information in a form and of a quality that is appropriate to discharge its function of monitoring corporate performance. For this purpose, clearly defined performance measures - financial and non-financial should be prescribed which would add to the efficiency and effectiveness of the organisation.

13. Monitoring the Board performance

The Board must monitor and evaluate its combined performance and also that of individual directors at periodic intervals, using key performance indicators besides peer review. The Board should establish an appropriate mechanism for reporting the results of Board's performance evaluation results.

14. Audit Committees

The Audit Committee is *inter alia* responsible for liaison with the management; internal and statutory auditors, reviewing the adequacy of internal control and compliance with significant policies and procedures, reporting to the Board on the key issues. The quality of Audit Committee significantly contributes to the governance of the company.

15. Risk Management

Risk is an important element of corporate functioning and governance. There should be a clearly established process of identifying, analyzing and treating risks, which could prevent the company from effectively

achieving its objectives. It also involves establishing a link between risk-return and resourcing priorities. Appropriate control procedures in the form of a risk management plan must be put in place to manage risk throughout the organization. The plan should cover activities as diverse as review of operating performance, effective use of information technology, contracting out and outsourcing.

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2013 - June [4] (b) Discuss briefly the following:

(i) Kautilya's four-fold duty of a king

(3 marks)

Answer:

Please refer 2012 - June [4] (b) (i) on page no. [22](#)

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2013 - Dec [3] (a) Corporate governance is still evolving in India. Trace the major principles of corporate governance in India as recommended by Kumar Mangalam Birla Committee and N.R. Narayana Murthy Committee appointed by the Securities and Exchange Board of India (SEBI) **(7 marks)**

(b) "The Board of directors plays a pivotal role in ensuring good governance." In the light of this statement, discuss the role of directors in a company. **(4 marks)**

Answer:

(a) Principles of Corporate Governance

The aim of corporate governance principles is to align the interest of individuals and community goals, corporations and society in the following ways:

- 1. Transparency:** Companies have to be transparent. Transparency means accurate, adequate and timely disclosure of relevant information to the stakeholders. Transparency disclosure provide information to the stakeholders that their interests are being taken care of.

2. **Accountability:** Chairman, Board of Directors and chief executive of the company should fulfill their accountability to the shareholders, customers, workers, society and the government. Since they have considerable authority over company's resources, they should accept accountability for all their decisions and actions.
3. **Independence:** For ethical reasons, corporate governance seems to be independent, strong and non-participatory body where all decision-making is based on business and not personal biases.
4. **Reporting:** Good corporate governance involve adequate reporting to shareholders, other stakeholders, for example, a company should publish quarterly, half yearly and yearly performance and opening results in news papers. It should also report the functioning of various committees set by the Board of Directors for efficient administrations. It is important on ethical grounds of the society.

Answer:

(b) The Board of Directors has the following role:

1. **To establish an organizational vision and mission giving strategic direction and advice:** Fundamental to the operation of any business is its strategy. Boards are in an excellent position to provide input and advice to the CEO and the top management regarding the company's strategic direction.
2. **Overseeing strategy implementation and performance:** The board plays a crucial role in advising, evaluating and monitoring strategy implementation.
3. **Developing and evaluating the CEO:** The evaluation of CEO and top management team is a very important activity of the Board. In the rapidly changing (environment, Boards need to be proactive in) evaluating the performance of CEO and top management team.
4. **To ensure, the organization has sufficient and appropriate human resources:** The board is responsible for:
 - (i) Hiring the senior staff person;
 - (ii) Giving direction to the senior staff person; and
 - (iii) Evaluating the senior staff person.

5. **Ensuring effective shareholders relations:** To serve as a communications link with members and others involved in an organization.
6. **Risk Mitigation:** Directors are expected to identify and manage obstacles that may prevent the organisation from reaching its goals.
7. **Procuring resources:** Financial resources, human resources, technological resources, business relationship are the key resources that are essential to an organization's success. Boards play an important role in helping the organization procuring the resources.

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2013 - Dec [6] (b) What is understood by the term 'stakeholder'? Enumerate the different stakeholders of any corporate entity. **(5 marks)**

Answer:

Stakeholder: Stakeholders provide resources that are more or less critical to a firm's long-term success. These resources may be both tangible and intangible. Shareholders, for example supply capital, supplier offers material resources or intangible knowledge, employees and managers grant expertise, leadership, and commitment, customers generate revenue and provide infrastructure and the society builds its positive corporate images. The classic definition of a stakeholder is 'any group or individual who can affect or is affected by the achievement of the organization's objectives'.

Different Stakeholders:

- (i) Primary stakeholders are those whose continuous association is absolutely necessary for a firm's survival. These include, employees, investors and shareholders, as well as the governments and communities that provide necessary infrastructure.
- (ii) Secondary stakeholders do not typically engage in transactions with a company and thus are not essential for its survival; these include the media, trade associations and special interest groups.

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2014 - June [1] {C} (b) Discuss in brief the following:

- (i) Arthashastra talks of self discipline for a king and six enemies which a king should overcome. **[Old Syllabus] (2 marks)**
- (iii) Corporate governance is integral to the existence of a company. **[Old Syllabus] (2 marks)**

Answer:

- (i) Arthashastra talks self-discipline for a king and the six enemies which a king should overcome – lust, anger, greed, conceit, arrogance and foolhardiness. In the present day context, this addresses the ethics aspect of businesses and the personal ethics of the corporate leaders.
- (iii) Corporate Governance is needed to create a Corporate Culture of Transparency, accountability and disclosure. It refers to compliance with all the moral and ethical values, legal framework and voluntary adopted practices. This enhances customer satisfaction, shareholder value and wealth.

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2014 - Dec [1] (b) Briefly comment on the following:

- (ii) ICSI principles of Corporate Governance, *inter alia*, include sustainable development of all stakeholders and adherence to ethical standards. **(2 marks)**

Answer:

ICSI Principles of Corporate Governance

Sustainable development of all stakeholders	Ensure growth of all individuals associated with or affected by the enterprise on sustainable basis.
Adherence to ethical standards	Ensure integrity, transparency, independence and accountability in dealings with all stakeholders.

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2014 - Dec [5] (a) Explain briefly the following:

(ii) Thesis of stakeholder theory.

[Old Syllabus] (3 marks)

Answer:

THESIS IN STAKEHOLDER THEORY

There are four thesis viewing stakeholder theory as:

- 1. Descriptive:** The theory is used to describe specific corporate characteristics such as nature of the firm, the way managers think about managing, how corporations are managed or how the board members think about the interests of constituencies.
- 2. Instrumental:** Instrumental stakeholders are defined by the need of the management to take them into account when trying to achieve their goals.
- 3. Normative:** This approach is categorical in effect it says— ‘Do (don’t do) this because it is the right (wrong) thing to do’.
- 4. Broadly managerial:** It recommends attitudes, structures and practices that taken together constitute stakeholder management.

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2015 - June [1] (b) (iv) Justify the ICSI principles of Corporate Governance on ‘sustainable development of all stakeholders’, ‘discharge of social responsibility’ and ‘effective management and distribution of wealth’ which seem to be very important principles for corporate. **(2 marks)**

Answer:

Corporate Governance is the application of best management practices, compliance of law in true letter and spirit and adherence to ethical standards for effective management and distribution of wealth and discharge of social responsibility for sustainable development of all stakeholders.

‘Sustainable development of all stakeholders’ ensures growth of all individuals associated with or affected by the enterprise on sustainable basis. ‘Discharge of social responsibility’ ensures that enterprise is acceptable to the society in which it is functioning. ‘Effective management and distribution of wealth’ ensures that enterprise creates maximum wealth and judiciously uses the wealth so created for providing maximum benefits to all stakeholders and enhancing its wealth creation capabilities to maintain sustainability.

2015 - Dec [4] (c) How important is corporate governance for success of an organisation? **(5 marks)**

Answer:

Importance of Corporate Governance for success of an organization:

1. Improved governance structures and processes help ensure quality decision-making, encourage effective succession planning for senior management and enhance the long-term prosperity of companies, independent of the type of company and its sources of finance.
2. Investors consider corporate Governance as important as financial performance when evaluating companies for investment. Investors who are provided with high levels of disclosure & transparency are likely to invest openly in those companies.
3. Good corporate governance systems attract investment from global investors, which subsequently leads to greater efficiencies in the financial sector.
4. Companies that are transparent, and have sound system that provide full disclosure of accounting and auditing procedures, allow transparency in all business transactions, provide environment where corruption will certainly fade out.
5. Improved management accountability and operational transparency fulfill investor's expectations and confidence on management and corporations, and in return, increase the value of corporations.

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2016 - June [1] (b) Briefly comment on the following statement:

- (iii) Independent Board is essential for sound corporate governance.

(2 marks)

Answer:

Independent Board is essential for sound corporate governance. This goal may be achieved by associating sufficient number of independent directors with the Board. Independence of directors would ensure that there are no actual or perceived conflicts of interest. It also ensures that the Board is effective in supervising and, where necessary, challenging the activities of management. The Board needs to be capable of assessing the performance of managers with an objective perspective.

2016 - June [2] Elucidate the following:

(c) Corporate excellence through governance.

(5 marks)

Answer:

Please refer 2011 - June [2] (a) (iii) on page no. [18](#)

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2016 - Dec [1] (b) Answer the following in brief:

- (i) An owner selects the agent to work in good faith to protect their interest and remain faithful to their goals. Who do you think are the agents and owners in modern organisations? **(2 marks)**

Answer:

According to agency theory, managers act as 'Agents' of the corporation. The owners set the central objectives of the corporation. Managers are responsible for carrying out these objectives in day-to-day work of the company.

In agency theory, the owners are the principals. But principals may not have knowledge or skill for getting the objectives executed. Thus, principal authorises the managers to act as 'Agents' and a contract between principal and agent is made. Under the contract of agency, the agent should act in good faith. He should protect the interest of the principal and should remain faithful to the goals.

In modern corporations, the shareholdings are widely spread. The management (the agent) directly or indirectly selected by the shareholders (the Principals), pursue the objectives set out by the shareholders, the main thrust of the Agency. Theory is that the actions of the management differ from those required by the shareholders to maximize their return. The principals who are widely scattered may not be able to counter this in the absence of proper systems in place as regards timely disclosures, monitoring and oversight. Corporate Governance puts in place such systems of oversight.

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2016 - Dec [2] Elucidate the following:

(a) Need for corporate governance

(5 marks)

Answer:

Corporate Governance is required to create a corporate culture of transparency, accountability and disclosure. It refers to compliance with all the moral and ethical values, legal framework and voluntarily adopted practices.

It helps organisations to achieve and improve:

- (i) Corporate Performance
- (ii) Enhance Investor Trust
- (iii) Better Access to Global Market
- (iv) Combating Corruption
- (v) Enhancing Enterprise Valuation
- (vi) Reduced Risk of Corporate Crisis and Scandals
- (vii) Accountability
- (viii) Efficiency with which a corporation employs assets
- (ix) Ability to attract low-cost capital
- (x) Ability to meet societal expectations.

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2018 - June [1] (b) Answer the following in brief:

(iii) Discuss the role and powers of the Board with respect to good corporate governance. **(2 marks)**

(c) “Good Corporate Governance is about intellectual honesty and not just sticking to rules and regulations. It has been observed that capital comfortably flows toward companies that practice this type of good governance”. Briefly comment. **(5 marks)**

Answer:

(iii) As an element of good corporate governance the role of the Board should be clearly documented in a Board Charter. The Board as a main functionary is primary responsible to ensure value creation for its stakeholders. The absence of clearly designated role and powers of Board weakens accountability mechanism and threatens the achievement of organizational goals. Therefore, the foremost

requirement of good governance is the clear identification of powers, roles, responsibilities and accountability of the Board, CEO, and the Chairman of the Board.

Role and Powers of the Board:

- The Board should retain full and effective control over the company and monitor the executive management.
- Board should exhibit total commitment to the company. An efficient and independent Board should be conscious of protecting the interests of all stakeholders and should attend and actively participates in the meetings.
- The Board should ensure a clearly accepted division of responsibilities at the top level of a company, which will ensure a balance of power and authority.
- The Board should ensure the company's prosperity by collectively directing the company's affairs, whilst meeting the appropriate interests of its shareholders and stakeholders.

(c) Good Corporate Governance is integral to the existence of the company and ensures the following:

- (a) Corporate Performance:** Improved governance structures and processes ensure quality decision making, encourage effective succession planning for senior management and enhance long-term prosperity of companies.
- (b) Enhanced Investor Trust:** Investors consider corporate governance as important financial performance when evaluating companies for investment.
- (c) Better Access to Global Market:** Corporate governance systems attracts investments from global investors.
- (d) Combating Corruption:** Companies that are transparent, provide environment where corruption would certainly fade out.
- (e) Easy Finance from Institutions:** The credit worthiness of a company can be trusted on the basis of corporate governance practiced in the company.

- (f) **Enhancing Enterprise Valuation:** Improved management accountability and operational transparency increases the value of corporation.
- (g) **Reduced Risk of corporate crisis and scandals:** Effective corporate Governance ensures efficient risk mitigation systems in place.
- (h) **Accountability:** Good Corporate Governance practices create the environment whereby Boards cannot ignore their accountability to the stakeholders.

The above mentioned factors make it clear that good corporate governance can help companies improve their performance and gain access to capital.

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2018 - June [2] (b) “Independent directors are directors who apart from receiving director’s remuneration do not have any other material pecuniary relationship or transactions with the company, its promoters, its management or its subsidiaries”. Elucidate. **(5 marks)**

Answer:

Pecuniary relationship between a company and its Independent Director raises serious concerns on the independence of the director. Such a relationship may adversely influence an Independent Director’s objectivity when it comes to taking key decisions and also results in conflict of interest of the concerned director.

Section 149(6) (c) who has or had no pecuniary relationship, other than remuneration as such director or having transaction not exceeding 10% of his total income or such amount as may be prescribed, with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year.

— Space to write important points for revision —

2018 - June [3] (a) “The institutional investors should use their powers and influence to ensure the implementation of the best practices set out in the Combined Code (2008)”. In the light of this statement state the observations of Kumar Mangalam Birla Committee on the principles of good corporate governance for the Institutional Shareholders in Indian scenario.

(5 marks)

Answer:

Principles of good corporate governance for the Institutional Shareholders in Indian Scenario:

1. Institutional shareholders should publicly disclose their policy on how they will discharge their stewardship responsibilities.
2. Institutional shareholders should have a robust policy on managing conflicts of interest in relation to stewardship which should be publicly disclosed.
3. Institutional shareholders should monitor their investee companies.
4. Institutional shareholders should establish clear guidelines on when and how they will escalate their stewardship activities.
5. Institutional shareholders should be willing to act collectively with other investors where appropriate.
6. Institutional shareholders should have a clear policy on voting and disclosure of voting activity.
7. Institutional shareholders should report periodically on their stewardship and voting activities.

— Space to write important points for revision —

2019 - June [2] (c) Whether the rule of majority, was established in the case of *Foss v. Harbottle* [(1843) 67 ER 189], is still relevant ? Narrate your answer with relevant provisions of the Companies Act, 2013 and in light of the decided case law.

(5 marks)

Answer:

In the case of *Foss v. Harbottle* [1843], it was held that the Courts would not generally interfere with the decisions of the company which it was empowered to take in so far they had been approved of by the majority and made exceptions to breaches of charter documents, fiduciary duties and

frauds or oppression and inadequate notice to the shareholders. The principle is still relevant as the court was right in ruling that every shareholder is bound by the terms and conditions of incorporation of the company, which operated as a set of mutually binding obligations.

However, in the process of implementing the objectives of the company, one should not override the legitimate expectations of minority shareholders. The following are the various sections which deal with the minority shareholders under the Companies Act, 2013.

- Oppression & Mismanagement [**Sections 241-246**]
- Class Action Suits [**Section 245**]
- Appointment of director by small shareholders (**Section 151**)
- Promoting the confidence of minority shareholders (Schedule IV - Code for Independent Directors).

Case: In a judgment by Supreme Court, upholding the landmark judgement passed by Madras High Court (HC), ordered SV Global (SVG) Mill, which was carved out of the 200- year-old textiles major Binny, to pay ₹ 100 crore to minority shareholders to buy them out. The minority shares were owned by S Natarajan, one of the original promoters of Binny and his associates. The Apex court, under Article 142 of the Constitution, directed that a sum of ₹ 100 crore be paid, to the respondents (associates of Natarajan) for the buyout of all the respondents' shares in the company.

— Space to write important points for revision —

2019 - Dec [2] (a) In year 2017, the SEBI has constituted a Committee on Corporate Governance under the Chairmanship of Mr. Uday Kotak with the aim of improving standards of Corporate Governance of listed companies in India. List out the recommendations given by this Committee. **(5 marks)**

Answer:

In 2017 the SEBI had constituted a Committee on Corporate Governance under the Chairmanship of Mr. Uday Kotak with the aim of improving standards of corporate governance of listed companies in India. The recommendations of the Committee were as follows:

- Composition and Role of the Board of Directors i.e. Minimum no. of Directors on a Board, Gender Diversity on Board, Attendance of Directors, Quorum for Board Meetings, Minimum no of Board Meetings, Maximum no. of Directorships etc.
- The Institution of Independent Directors i.e. Minimum nos. of Independent Directors, Eligibility Criteria for Independent Directors, Minimum compensation to Independent Directors, Lead Independent Directors, Casual vacancy of Independent Directors etc.
- Board Committees i.e. Composition and Role of Audit Committee, Nomination, Remuneration and Stakeholder Relationship Committee etc.
- Enhanced Monitoring of Group Companies i.e. Obligation on the Board of the Listed Co. with respect to subsidiaries, Secretarial Audit) etc.
- Promoters/ Controlling Shareholders and Related Party Transactions i.e. Disclosure and Approval of Related Party Transactions, Royalty and Brand Payments to Related Party, Remuneration to Executive Promoters Directors and Non- Executive Directors etc.
- Disclosures and Transparency pertaining to Submission of Annual reports, Disclosures pertaining to Credit Rating, Disclosures pertaining to Directors, Disclosures pertaining to Disqualification of Directors, Disclosures pertaining to Subsidiary Accounts, Prior Intimation of Board meeting to discuss Bonus Issue, Disclosure on Website etc
- Accounting and Audited related issues i.e. Audit Qualifications, Independent External opinion by Auditors, Group Audits, Quarterly financial controls, Internal financial control, IND-AS adoption, Disclosure of Audi fees of Auditors etc.
- Investors participation in Meetings of Listed Entities i.e. Timeline for AGM in listed entities, E-voting and webcast of proceedings of meeting, Treasure Stock, Stewardship code).
- Governance aspects of Public Sector Enterprises.
- Leniency Mechanism.
- Capacity building in SEBI for enhancing Corporate Governance in Listed Entities.

In its board meeting on March 27, 2018, SEBI, after detailed consideration and due deliberation, accepted several recommendations of the Kotak Committee without any modifications and accepted a few other recommendations with certain modifications as to timelines for implementation, applicability thresholds among others.

— Space to write important points for revision —

2021 - Aug [2A] (Or) (ii) The Finnish Corporate Governance Code 2020 (2020 CG Code) came into force and applicable to listed companies on Nasdaq Helsinki Ltd. (Helsinki Stock Exchange). What is the key recommendation with respect to Related Party Transaction in this Code ?

(5 marks)

PRACTICAL QUESTIONS

2009 - Dec [1] {C} (a) In United Kingdom, the Combined Code on Corporate Governance of 2008 is the result of studies made from time to time by various committees to prevent the recurrence of scandals and financial collapses experienced in 1980s and early 1990s, when Cadbury Committee was first set-up in 1992 which gave a new dimension to the Corporate Governance.

List out the three important recommendations made by Cadbury Committee and outline atleast five major landmarks in the historical development since the setting-up of the Cadbury Committee for improvement in the Corporate Governance.

(10 marks)

Answer :

Historical developments in the UK for the improvement in corporate governance since the setting of Cadbury Committee are as under:

- (i) The Cadbury Report, 1992
- (ii) The Greenbury Report, 1995
- (iii) The Hampel Report, 1998
- (iv) The Turnbull Report
- (v) Higgs Report

- (vi) Smith Report
- (vii) The Tyson Report
- (viii) The combined code on Corporate Governance as revised in 2003,
- (ix) The combined code of Corporate Governance, 2006,
- (x) The combined code of Corporate Governance, 2008,
- (xi) Walker Review of Corporate Governance of UK Banking Industry, 2009
- (xii) UK Corporate Governance Code (Revised), 2012
- (xiii) The UK Stewardship Code (Revised), 2012

(i) The Cadbury Report, 1992

Due to several scandals and financial collapses in the UK in the late 1980s and early 1990s, London Stock Exchange setup the Cadbury Committee in May 1991 to raise the standard of corporate governance or collapse in future. This committee in its report known as Cadbury Report, recommended mainly:

- Separating the role of CEO and Chairman of the Board
- Balanced composition of Board of Directors with executive and non executive directors
- Selection process for non executive directors.

(ii) The Greenbury Report, 1995

The Confederation of British Industry set up a group under the Chairmanship of Sir Richard Greenbury to examine the remuneration of the directors. It recommended the formation of Remuneration committee composed of non executive directors. Its recommendations were incorporated in the Listing Rules of The London Stock Exchange.

(iii) The Hampel Report, 1998

The Hampel Committee was set up to review the implementation of Cadbury and Greenbury Reports and to see that their purposes were being achieved. The Recommendations of the committee coupled with further consultations by the London Stock Exchange resulted in a combined code on Corporate Governance, the original combined code 1998.

- (iv) The Turnbull Report**
A working group under the Chairmanship of Nigier Turnbull recommended the internal Control Guidance for Directors which were included in the combined code.
- (v) Higgs Report**
The combined code was reviewed in July 2007 by Derek Higgs about the role and effectiveness of non – executive directors.
- (vi) Smith Report**
A group under The Chairmanship of Sir Robert Smith was set up to develop guidance for Audit Committee in the combined code.
- (vii) The Tyson Report**
The Tyson Report was recommended on the recruitment and development of non –executive directors.
- (viii) The combined code on Corporate Governance as revised in, 2003**
The basis of recommendations of all the reports the combined code was revised in 2003.
- (ix) The combined code on Corporate Governance, 2006**
The combined code on Corporate Governance was again revised in 2006.
- (x) The combined code on Corporate Governance, 2008**
The combined code on Corporate Governance, 2008 sets out standards of good practice in relation with shareholders. All companies incorporated in the UK and listed on the London Stock Exchange are required to report in their annual reports and accounts about the implementation of the combined code on Corporate Governance.
- (xi) Walker Review of Corporate Governance of UK Banking Industry, 2009**
The principal focus of this Review has been on banks, but many of the issues arising and associated conclusions and recommendations, are relevant – if in a lesser degree – for other major financial institutions such as life assurance companies. The terms of reference are as follows:
To examine corporate governance in the UK banking industry and make recommendations, including in the following areas: the

effectiveness of risk management at board level, including the incentives in remuneration policy to manage risk effectively; the balance of skills, experience and independence required on the boards of UK banking institutions; the effectiveness of board practices and the performance of audit, risk, remuneration and nomination committees; the role of institutional shareholders in engaging effectively with companies and monitoring of boards; and whether the UK approach is consistent with international practice and how national and international best practice can be promulgated.

(xii) UK Corporate Governance Code (Revised), 2012

Revised version of earlier code (2010) includes that boards should confirm that the annual report and accounts taken as a whole are fair, balanced and understandable, that audit committees should report more fully on their activities and that FTSE 350 companies should put the external audit contract out to tender at least every ten years.

(xiii) The UK Stewardship Code (Revised), 2020

The Stewardship Code aims to enhance the quality of engagement between institutional investors and companies to help improve long-term returns to shareholders and the efficient exercise of governance responsibilities. Engagement includes pursuing purposeful dialogue on strategy, performance and the management of risk, as well as on issues that are the immediate subject of votes at general meetings. The Code is addressed in the first instance to firms who manage assets on behalf of institutional shareholders such as pension funds, insurance companies, investment trusts and other collective investment vehicles.

— Space to write important points for revision —

2012 - Dec [1] {C} (a) “Kautilya’s Arthashastra maintains that ‘for good governance, all administrators, including the king were considered servants of the people. Good governance and stability were completely linked.’ If the king is substituted with the Board of directors, the same principle can be applied with Corporate Governance.”

In the light of the above statement, discuss the fourfold duties of the Board of directors with regard to Corporate Governance as enunciated by Kautilya and explain the six enemies of governance, which should be overcome by the Board of directors for ensuring good Corporate Governance. **(10 marks)**

Answer :

“Kautilya’s Arthashastra maintains that for good governance, all administrators, including the king were considered servants of the people. Good governance and stability were completely linked”.

If the king is substituted with the Board of Directors and the subjects with the shareholders, the concept of good governance prevails. This is because the concept of corporate governance believes that public good should be ahead of private good and that the corporation’s resources cannot be used for personal benefit. The four fold duties of a king as mentioned in Arthashastra are as follows:

1. Raksha - literally means protection
2. Vriddhi - literally means growth
3. Palana - literally means maintenance/compliance
4. Yogakshema - literally means well being

Arthashastra mention self-discipline for a king and the six enemies which a king should overcome-lust, anger, greed, conceit, arrogance and foolhardiness. In the present day context, this addresses the ethics aspect of businesses and the personal ethics of the corporate leaders.

— Space to write important points for revision —

2014 - Dec [1] (a) “The Board of directors plays a pivotal role in ensuring good governance. The role of the Board is two-dimensional; as a cornerstone in evolving sound, efficient, vibrant and dynamic corporate for attaining of high standards in integrity, transparency, code of conduct, accountability as well as in promoting social responsibility. The contribution of the directors on the Board is critical to the way a corporate conducts itself. An effective Board evaluation requires the right combination of dynamic factors of performance of the Board as entrepreneurial leader of the company within the framework of prudent and effective controls, which enables risk to be assessed and managed.” **(10 marks)**

Answer:

The Board of Directors plays a pivotal role in ensuring good governance. The contribution of directors on the Board is critical to the way a corporate conducts itself. A board's responsibilities derive from law, custom, traditional and current practice. In the present times transparency, disclosure accountability, issues of sustainability, corporate citizenship, globalization are just some of the concerns that the Boards have to deal with. In addition, the Boards have to respond to the explosive demands of the marketplace. This two dimensional role of the Board of Directors is cornerstone in evolving sound, efficient, vibrant and dynamic corporate sector for attaining of high standards in integrity, transparency, code of conduct, accountability as well as the social responsibility.

As per **Section 2(10) of the Companies Act, 2013** "Board of Directors" or "Board", in relation to a company means the collective body of directors of the company.

A board of directors is a body of elected or appointed members who jointly oversee the activities of a company. They are also referred as board of governors, board of managers, board of regents, board of trustees or simply referred to as "the board".

Sub Section (2) of Section 178 of the Companies Act, 2013 provides that the Nomination and Remuneration Committee shall identify persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, recommend to the Board their appointment and removal and shall specify the manner for effective evaluation of performance of Board, its committees and individual directors to be carried out either by the Board, by the Nomination and Remuneration Committee or by an independent external agency and review its implementation and compliance.

Further, **Schedule IV of the Companies Act, 2013** provides for the following evaluation mechanism of independent directors:

- (i) The performance evaluation of independent directors shall be done by the entire Board of Directors, excluding the director being evaluated.

- (ii) On the basis of the report of performance evaluation, it shall be determined whether to extend or continue the term of appointment of the independent director.

Section 134(3) (p) provides that in case of a listed company and every other public company having such paid up share capital as may be prescribed, a statement indicating the manner in which formal annual evaluation of the performance of the Board, its Committees and of individual directors has been made.

Regulation 17(10) of the SEBI (Listing Obligations & Disclosure Requirements) Regulations, 2015 provide that the evaluation of independent directors shall be done by the entire board of directors which shall include –

- (a) performance of the directors; and
- (b) fulfillment of the independence criteria as specified in these regulations and their independence from the management:

Provided that in the above evaluation, the directors who are subject to evaluation shall not participate.

Performance evaluation of the board:

- (i) How well has the board performed against any performance objectives that have been set?
- (ii) What has been the board's contribution to the testing and development of strategy?
- (iii) What has been the board's contribution to ensuring robust and effective risk management?
- (iv) Is the composition of the board and its committees appropriate, with the right mix of knowledge and skills to maximize performance in the light of future strategy? Are inside and outside the board relationships working effectively?
- (v) How has the board responded to any problems or crises that have emerged and could or should these have been foreseen?
- (vi) Are the matters specifically reserved for the board the right ones?
- (vii) How well does the board communicate with the management team, company employees and others?

- (viii) How effectively does it use mechanisms such as the AGM and the annual report? Is the board as a whole up to date with latest developments in the regulatory environment and the market?
- (ix) How effective are the board's committees? (Specific questions on the performance of each committee should be included such as, for example, their role, their composition and their interaction with the board.)

_____ Space to write important points for revision _____

2015 - June [1] (a) Ebbers built World Com from a small telecommunications company into a global giant. It all started back in 1984, when he invested in a local long-distance phone company. Soon he was invited to manage it. He made it grow through a series of aggressive, even audacious mergers. Eventually, it became a publically traded corporation with annual revenues of \$39 billion. As the company grew, so did Ebbers's wealth, but his extravagant spending forced him to use all of his WorldCom stock as collateral for bank loans to pay his debts. If its price fell too far, he would be bankrupt. About this time in 1990s, the dot-com investment bubble burst. WorldCom's revenue declined and expenses for its world-spanning fibre optic network rose more than anticipated. According to later investigations, in 2000, Ebbers gave the first in a string of instructions to his Chief Financial Officer to report false revenues and use accounting tricks to disguise rising expenses. The share prices held. However, internal auditors discovered the deceit and reported it to the Securities and Exchange Commission (SEC). The agency started an investigation. WorldCom's Board of directors forced Ebbers to resign. Soon the truth came out and WorldCom shares lost 90% of their value. In 2002, WorldCom set a record in failure, breaking Enron's previous total for the largest bankruptcy in American history. Although the company ultimately survived, 17,000 workers lost their jobs and investors lost billions.

The purpose of Corporate Governance is to improve governance in the corporate but the story of WorldCom presented above puts a question mark on the sanctity of Corporate Governance.

Analyse the failure of Corporate Governance and give recommendations to keep future company operations in order and avoid others from following the footsteps of Ebbers even though he was forced by the Board of directors to resign. **(10 marks)**

Answer:

Worldcom failure is one of the largest bankruptcy cases in American history, breaking even Enron's record. Ebbers invested in a local long-distance phone company in 1984, which he was invited to manage later. He made it grow into a global giant through a series of mergers Ebbers played a major role in the fraud. His extravagant spending forced him to take massive amount of bank loans by securing his Worldcom shares. When telecom industry was experiencing a down turn, at the same time Worldcom stock prices also started falling. In order to avoid margin call, he needed company's stock to perform well. Ebbers used unethical means to keep the company's stock price up. The fraud was directed by Ebbers and it was implemented through his CFO by reporting false revenues and using accounting tricks to disguise rising expenses. It came out when internal auditors discovered the deficit and reported the same to SEC.

There were major corporate governance failures in Worldcom which, mainly, were:

- internal control failure
- ineffective board
- lack of transparency

Recommendations to keep future company operations in order and avoid other from following the footsteps of Ebbers.

1. An Active, Informed and Independent Board:

A very high standard is required for the appointment of independent directors who should have adequate experience and qualification. With the exception of the CEO, majority of the members of the board must be fully independent.

2. A Non-Executive Chairman of the Board of Directors:

This recommendation requires every company to create the position of non-executive chairman of the board. The non-executive chairman shall have defined responsibilities relating to coordination with the board's

work, chairing meetings, coordinating with committee chairs, organizing CEO and board performance reviews, and similar issues. The non-executive chairman shall not be involved in the day to day management duties. The CEO remains fully responsible for all management decisions, subject to board oversight. The clear separation of the role of Chairman and CEO between two persons will maintain the balance of power and the CEO will be guided and reviewed by the Board.

3. **Independent Director:**

An independent director shall hold office for a term up to five years on the Board of a company, but shall be eligible for reappointment on passing of a special resolution by the company for another five years. This recommendation will ensure the independence of Independent Director.

4. **Active Board Committees:**

This recommendation prescribes that every company shall constitute an Audit Committee, Governance Committee, Nomination and Remuneration Committee and a Risk Management Committee. The CEO shall not serve as a member of any of these committees, so that each committee is composed entirely of independent directors.

5. **Auditor Independence:**

The statutory auditor shall be appointed for a maximum period of 10 years which will ensure the audit quality. An auditor shall provide to the company only such services as are approved by the Board of Directors of the audit committee, which shall not include non audit services. This recommendation will ensure the independence of statutory auditor.

6. **Compensation Limits:**

The Nomination and Remuneration Committee shall establish a maximum compensation level for any individual in any year without shareholder approval. A substantial part of the compensation shall not be linked to the share price, as this leads to the manipulation of the financial statements by the top management of the company to secure their own remuneration.

7. Enhanced Transparency, Internal Controls and Finance Department:

The recommendations suggest that the Company should intensify efforts to develop disclosure practices that will result in transparency of financial information beyond legal requirements.

— Space to write important points for revision —

Repeatedly Asked Questions		
No.	Question	Frequency
1	Elucidate the following: Corporate excellence through governance. 11 - June [2] (a) (iii), 16 - June [2] (c)	2 Times
2	Discuss briefly the following: Kautilya's four-fold duty of a king. 12 - June [4] (b) (i), 13 - June [4] (b) (i)	2 Times