

## Redefining the Role of Major Players in Corporate Governance

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*The metamorphosis of the Indian economy in the recent past has initiated new debate on the responsible behaviour of the corporate sector. The Cadbury Committee Report (1995) in UK which discussed the detail role of various players in CG has fuelled the discussion further. The Code for Best Practice (1992) of Sir Cadbury set up the broad framework on which the Report of 1995 elaborated the responsibility and accountability requirements of major players. However, the perception of Sir Cadbury need some change when it is supposed to be practised in India. This article has attempted to redefine the role of major players like Board of Directors, Auditors, Company Secretaries, Government and other regulatory agencies, and employees to suit the Indian conditions. But it is observed that the code of governance should come from the corporate system itself and not from outside.*

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The initiation of liberalisation process by Government of India during the early nineties has heralded new vistas for the corporate sector. The programmes and policies introduced are aimed at improving the efficiency of every sector of economy by structural transformation and by infusing new vitality through transparency and accountability. Removal of entry barriers, reduction of tariffs, relaxation in restrictions, opening of public sector for private participation, etc., are the few policy measures among the many. The attempt of global economic integrations has also metamorphosed the growth process by leashing out new and exciting opportunities. So all these sweeping changes have transformed the attitude and conduct of Indian industries both in domestic and international arena. Diversification, mergers, amalgamations, takeovers, technology tie-ups and joint ventures have become order of the day. MNCs have also changed their perception towards the economic stability due to the unequivocal consensus among the Indian political parties towards the liberalisation policies.

### The Need for Good Corporate Manoeuvre

With the sweeping changes in Indian economy and the growing aspiration of Indian industries to compete with the MNCs and to increase their market share, profitability, etc., has side by side enhanced their responsibility also. Although the reforms initiated during the last seven years witnessed some

radical changes in the rules and regulations to improve the stakeholder's confidence, the recent CRB fiasco, HLL's insider trading and other financial scams have eroded the investor's confidence. The levels of transparency and standards of disclosures observed by Indian companies leave much to be desired. The practice of placing personal interests above those of other stakeholders is quite widespread. There had been several instances in India over the last few years when institutional shareholders and independent directors on the board of a company have raised concern over the decisions of the management or promoters.

### **Genesis of the Concept of Corporate Governance**

While the need for better corporate management was felt just few years back in India, as a coincidence similar concerns were raised at the same time in England also. The first concern was that even big companies were so vulnerable to a change in economic circumstances. The second was about the adequacy of the controls that operated within companies. As a result of these two concerns, the issue of corporate governance (CG) became a live question in England and to tackle the issue the Cadbury Committee was created in early 1991. In 1992 the Committee published the Code of Best Practice, which emphasised the need for an adequate level of disclosures and for appropriate checks and balances within the governance structure. It had set out the principles or guidelines which the boards should follow in directing and controlling their companies. In May 1995 the Committee published a Report on Compliance which became popular because of its wide range of guidelines, principles and recommendations. These developments in England influenced the thinking about Corporate Governance in India also.

### **What is Corporate Governance?**

Corporate Governance (CG) in its useful sense refers to the accountability—relationship between the Board of Directors of a company and its shareholders. But by actual definition CG is not concerned so much with the manner in which companies are undertaking the day-to-day management of their affairs, but on the contrary, with the manner in which the management itself is controlled and directed by other agencies. It may be said to include the policies and procedures adopted by a company in achieving its objectives in relation to its shareholders, employees, customers and suppliers, regulatory authorities and community at large. In a normative sense, it prescribes a code of corporate conduct in relation to all the stakeholders, both external and internal. The new paradigm for corporate governance focuses on laying down minimum standards and defining the role of the various players involved in corporate governance. To sum up it is a dynamic system in which the company fulfils the long-term needs of all its stakeholders including the society at large with optimum accountability and transparency.

### **Role of Major Players in Corporate Governance**

Players are many in the system of corporate governance. Where the government and other regulatory agencies provide the platform through legislations

and rules, on the other side the board of directors, auditors, shareholders, financial institutions, accounting professionals, company secretaries and employees play their individual roles for the proper governance. However, on the wake of changes in the economy, their traditional roles need some fine tuning. The following discussion elucidates their respective roles.

(A) *Role of the Board of Directors*: The quality of Board is a deciding factor for good corporate governance. The composition and number are the determinants of quality. Even in a small concern the efficiency of the Board of Directors (BODs) is a crucial factor for the survival in a competitive environment.

The Companies Act, 1956 provides the basis for functioning of BODs through its provisions in various sections. The Working Group set up by Government of India to redraft the old provisions has made substantial improvements. The Group has recommended a Statement of Director's Responsibility (SDR) to be attached to the Annual Accounts for better transparency. The model of SDR reads: "Companies Act requires the directors to prepare financial statements for each financial year to give a true and fair view of the state of affairs of the company at the end of the year and of the profit or loss of the company for that period". In preparing these annual accounts the directors are required to select suitable accounting policies, apply them consistently and make judgements and estimates that are reasonable and prudent.

The directors must also specify whether applicable accounting standards have been followed or not, and disclose and explain any material departures in the financial statements. The annual accounts must be prepared on the going concern basis, unless it is inappropriate to presume that the company will continue in business. The directors are also responsible for the maintenance of adequate accounting records in compliance with the Companies Act, for safeguarding the assets of the company, and for preventing and detecting fraud and irregularities".

Besides the SDR, the Working Group has also emphasised on financial disclosures. But the suggestions shall only be fruitful when the Board is transparent and capable of doing things. The Board should be a expert body capable of guiding the management and overseeing the operations so as to subserve larger interest of those connected with the corporation. The board must be sure that the company has adequate information, control, and audit systems in place to guide the top management whether the company is meeting its business objectives. It is also the board's responsibility to ensure that the company complies with legal and ethical standards imposed by law and by the company's own statement of values. The Board itself shall be imbued with good ethical values and clear corporate vision. Above all, what is necessary to have on the board are people who are likely to encourage initiative and growth while ensuring the compliance of an institutionalised ethical system.

As the head of BODs, the role of chairman is very important. He should have a dynamic personality, clear corporate vision, adequate professional experience as well as the leadership quality. The ability and effectiveness of chairman

shapes the long-term prospects of a company. He has to run the board effectively, maintain good relationship with institutional shareholders, government, media and business and contribute towards the overall framework design of policy.

(B) *Role of Non-executive Directors:* Non-executive directors are the directors other than managing directors and functional directors. These are persons of excellence chosen from different fields with varied professional experience. The Code of Best Practices of Cadbury Committee states that the non-executive directors (NEDs) should be selected through a formal process and their nomination should be a matter for the board as a whole. They should be appointed for a specified term and reappointment should not be automatic. Thus appointment of NEDs of appropriate calibre, experience and complete independence is vital to good corporate governance. It is expected that NEDs should bring an independent judgement to bear on issues of strategy, performance and resources including key appointments and standards of conduct. In these days of growing competition and integration with global markets, the NEDs are supposed to act as the eyes and ears of the chairman. They should convey their expert views on different matters to the chairman in order to strike a proper balance between company's mission and competitive edge with transparency and accountability. They should protect the interest of not only the shareholders but also of all the stakeholders.

(C) *Role of Institutional Directors:* The role of nominee directors of financial institutions (FIs) in corporate board is very important. The new economic environment has changed their role from mere spectators to key players. Since the FIs hold a major chunk of shares in companies, their role is significant in a way to strength the accountability. In pursuit of this objective, the FIs have prescribed 19 point agenda for nominees in companies. The important points in this agenda are:

- Well defined and declared long-term dividend policies.
- Depreciation charging method should be examined.
- Investments in unlisted companies to be carefully examined.
- No resource raising in the form of equity or loans unless required for expansion and long-term working capital needs.
- Transfers of profitable divisions and hiving-off require approvals.
- The impact of merger on the equity shareholding pattern and on promoter holding to be examined.
- Loans and advances for share acquisition should be examined.

The areas in which they are expected to play an effective role include crucial areas such as investments in subsidiaries and loans, awards of contracts, merger and acquisitions, expansion and diversification, dividend and accounting policies and subsidiarisation and de-subsidiarisation. The list of guidelines and the areas prescribed is not static. It will keep on changing with the need. But what is important to the nominee is to act in a cohesive manner with other directors on the board.

(D) *Role of Audit Committee*: As per the recommendation of the Cadbury Committee, all the listed companies in UK should establish audit committees within a specific period. Although this practice is not prevalent in India, few companies have taken initiative in this direction. Such committee is desirable due to the fact that a director individually may not be so competent to look after important financial matters. It is essentially to include non-executive directors as members of audit committees to protect the interest of investors.

The Cadbury Committee has succinctly pointed the potential of such entity in the areas of quality financial reporting, controlling of fraud, providing channel of communication with external auditor, helping the finance director, enhancing the credibility of financial statements, etc. The committee members should be competent, committed and independent. But its overall effectiveness will depend on the attitude of promoters and executives towards the good practices of corporate governance.

(E) *Role of Accounting Professionals*: The growing complexities of business has changed the traditional role of accounting professionals. Besides the auditing function, they are now being contracted to provide non-financial professional services to their clients. On the wake of demand for good corporate governance from every quarter, the need arises for a redefinition of their role. The Working Group on recently amended Companies Act '97 observed "integrity of accounting and auditing procedures and the quality of financial disclosure are fundamental to corporate transparency and long-term shareholders support". But in the present day context auditor is not only responsible to the management and shareholders, but also to all the stakeholders of the company. The collapse of big companies and financial institutions, even after getting unqualified report from the auditor, has eroded the confidence of general public. So the doubt regarding the *modus operandi* of the accounting professionals genuinely arises. It is high time for them to rise upto the expectation of the public. They should move away from merely reporting on financial information, but to other areas. The activity should not only look at the reliability of accounting and reporting, it must cover all relevant business processes from brand management to customer service. Auditors should enhance their value adding capability in every role they perform, independent of the continuance of their contract with the client. They should give their expert opinion on matters like strategic planning, product profitability and greater transparency.

(F) *Role of Company Secretaries*: On the role of company secretaries the Cadbury Committee commented "the company secretary has a role to play in ensuring that board procedure are both followed and regularly reviewed. The chairman and the board will look to the company secretary for guidance on what their responsibilities are under the rules and regulations to which they are subject and on how those responsibilities should be discharged. All directors should have access to the advice and services of the company secretary and should recognise that the chairman is entitled to the strong and positive support of the company secretary in ensuring the effective functioning of the board...." This observation clearly sets a new role for the company secretaries.

They have to give independent professional advice to the board of directors. Further there is need for secretarial audit before the financial audit to ensure compliance of all the requirements of law. This will restore confidence of the investors on the company. In sum, company secretaries have to set a new standard of performance to restore public confidence in this profession.

(G) *Role of Government and Other Law Making Agencies:* Since the introduction of Indian Companies Act 1956 the Government of India has added many legislations and new Acts to make corporate sector more accountable and their working more transparent. But none of the Acts emphasises on maximum level of corporate governance in a systematic manner. Although the Company Law Board and other regulating agencies like RBI, SEBI, etc., have been modifying the provisions from time to time, still the corporate sector in India is lacking maturity in good governance. Some of the important laws in corporate accountability and transparency are:

- Monopolistic and Restrictive Trade Practices Act, 1973.
- Consumer Protection Act, 1986.
- RBI Guidelines for Non-Banking Finance Companies.
- SEBI Guidelines for Capital Market.
- SEBI (Insider Trading) Regulations, 1992.
- SEBI (Prohibition of Fraudulent and Unfair Trade Practices) Regulations, 1995.
- The Depositories Act, 1996.
- Foreign Exchange Management Act, 1997 (Not finalised).
- New Takeover Code and SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.

Through these laws many changes have been inserted and new provisions came into existence. Many barriers, restrictions, etc., are also lifted during the ongoing period of liberalisation. Still the corporate sector in India does not live upto the expectations of investing public and society at large. By unleashing the Indian corporate sector to a great extent and by enacting laws shall not raise the level of accountability and responsibility. Here it should be kept in mind that law can not built up a complete ethical man. It only provides the basis for practising ethics. The government and other regulatory agencies should play the role of watch dog through their timely intervention and strong action.

(H) *Role of Employees:* A good team of employees is the backbone of a company. But what is important is that their individual ethical standard. A responsible employee should be altered enough to point out the wrong doings of his superior. When employees are shareholders of a company, their responsibility rises further. They should have to raise issues in the appropriate form for prompt action.

### Epilogue

On the wake of changes in domestic and international economies, the old perception of corporate world has changed drastically and expectation from every