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**HYPOTHESIS (ES)**
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**RESULTS & DISCUSSION**
**FINDINGS**
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**CONCLUSIONS**
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# COMPANIES ACT 2013: A NEW INITIATIVE TOWARDS CORPORATE GOVERNANCE

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## ABSTRACT

*In 1991 amidst severe financial crisis, the government initiated economic reforms aimed at deregulation, liberalization and globalization. A number of policy changes were made to stimulate economic growth, and for sustaining the economic growth and enabling Indian companies to access funds abroad required a well defined corporate governance framework. A historic step in this direction was setting up of India's security market regulator – Securities & Exchange Board of India in 1992. Lobbying by industry groups & increased presence of foreign investors led to a number of corporate governance reforms aimed at addressing the lacuna in the governance framework which at that time was in its infancy. The Companies Act, 2013 has replaced the existing 56 year old company law, i.e. Companies Act, 1956. The Act has become fully operational since 1st April, 2014. The new Indian Companies Act, 2013 is a positive and welcoming step towards modernizing India's company law and places India on par with corporate legislation elsewhere in the globe. The Act is a progressive and forward looking which promises improved corporate governance norms, enhanced disclosures and transparency, facilitation of responsible entrepreneurship, increased accountability of company managements and auditors and stricter enforcement processes. The introduction of Corporate Social Responsibility as an integral function of corporate operations is the most significant step and also the levy of heavier penalties for transgressions from fulfillment of its obligations. Overall, the Act promises to significantly raise the bar on Corporate Governance and will radically alter the framework in a positive sense.*

## KEYWORDS

Corporate Governance, Corporate Social Responsibility (CSR), e-governance initiatives.

## INTRODUCTION

The long awaited Companies Bill, 2012 was passed by the Lok Sabha on 18th December, 2012 and by the Rajya Sabha on 8th August, 2013. On receiving the assent of the Honourble President of India on August 29, 2013, it was notified on August 30, 2013 as the Companies Act, 2013. The Companies Act, 2013 has replaced the existing 56 year old company law, i.e. Companies Act, 1956. The Act has become fully operational since 1st April, 2014. It provides for good corporate governance, business friendly corporate regulation, e-governance initiatives, Corporate Social Responsibility, enhanced disclosure norms, enhanced accountability of management, audit accountability, protection for minority shareholders, investor protection and activism and better framework for insolvency regulation and institutional structure. The term 'Corporate Governance' gained prominence in the recent times when the corporate sector across the globe was hit by scandals and big companies like Enron, WorldCom bridled with questionable corporate policies collapsed. India too had its share of scam with Satyam being an incident thought to be the first of its kind. Though reforms in the area of corporate governance have been underway since 1990s, it was not until the Satyam scandal that exposed glaring gaps in the governance structure and auditing practices in the country that acted as a catalyst for a modern legislation. The Companies Act, 2013 is a move by the government to strengthen the corporate governance framework in a country where most of the businesses are characterized by concentrated shareholding and channeling of funds. The Act encourages good governance practices by placing the onus on independent directors to bring oversight in the functioning of the Board and protect the interest of minority shareholders. Corporate Social Responsibility has achieved business prominence due to the activities of pressure groups and also the emergence of the "market for virtues" such as Socially Responsible Investment that create further pressures to adopt CSR initiatives. This paper focuses on Companies Act, 2013 & its provision on mandatory spending and disclosure of Corporate Social Responsibility activities.

## OBJECTIVES OF THE STUDY

The study has been geared towards achieving the following objectives:

1. To examine key provisions under Companies Act, 2013;
2. To understand the implications of Companies Act, 2013;
3. To propagate information about the latest happenings in the Company Law field to people engaged in policymaking, policy analysis, policy research and other Stakeholders;

## RESEARCH METHODOLOGY

The research paper is an attempt of exploratory research, based on the secondary data sourced from journals, magazines, articles and media reports. Looking into requirements of the objectives of the study the research design employed for the study is of descriptive type. Keeping in view of the set objectives, this research design was adopted to have greater accuracy and in depth analysis of the research study. Available secondary data was extensively used for the study. The investigator procures the required data through secondary survey method. Different news articles, Books and Web were used which were enumerated and recorded.

## EVOLUTION OF CORPORATE GOVERNANCE INITIATIVES IN INDIA

In 1991 amidst grave financial crisis, the government initiated economic reforms aimed at deregulation, liberalization and globalization. A number of policy changes were made to stimulate economic growth, domestic competitiveness and industrial efficiency. Sustaining the economic growth and enabling Indian companies to access funds abroad required a well defined corporate governance framework. A historic step in this direction was setting up of India's security market regulator – Securities & Exchange Board of India in 1992. Lobbying by industry groups & increased presence of foreign investors led to a number of corporate governance reforms aimed at addressing the lacuna in the governance framework which at that time was in its infancy.

**a) SEBI Kumar Mangalam Birla Committee (1999)**

The second major initiative was taken by SEBI in 1999 when it set up a committee under the chairmanship of Kumar Mangalam Birla to review the corporate governance standards. The committee submitted its report in 2000 containing 25 recommendations which primarily focused on board representation and independence. The committee laid specific emphasis on constitution and function of Audit Committees. The recommendations comprised of mandatory and non mandatory provisions. SEBI implemented the Birla Committee proposal in the form of insertion of historic code of corporate governance – Clause 49 in the Listing Agreement (2000) with immediate effect.

**b) SEBI Narayan Murthy Committee (2003)**

In late 2002, SEBI constituted another committee on corporate governance chaired by Shri N.R. Narayana Murthy. SEBI formed the Murthy Committee in the wake of the scandals like Enron and WorldCom in the United States in order to review the adequacy of the existing Clause 49. The recommendations primarily related to expanding the responsibilities of Audit Committee, revised the independent director definition, position of nominee directors, enhanced disclosure of risk management strategies. These recommendations were reinforced through revising Clause 49 which came into effect from Jan 1, 2006.

## THE COMPANIES ACT, 2013: KEY PROVISIONS

The Companies Act, 2013 introduces significant change in the provisions related to governance, management, compliance and enforcement, disclosure norms, auditors and mergers and acquisitions.

**BOARD FRAMEWORK:** The Companies Act, 2013 states that:

**NUMBER OF DIRECTORS**: The following key changes have been introduced regarding composition of the board:

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

**Key Removals:** Allowing companies to increase the number of directors on their boards by way of a special resolution would ensure greater flexibility to companies.

**Companies Act 2013 requires companies to have the following classes of directors:**

**INDEPENDENT DIRECTORS**

Companies Act, 1956 did not require companies to appoint an independent director on its board. Provisions related to independent directors were set out in Clause 49 of the Listing Agreement.

**a) Number of independent directors**: As per the Listing Agreement, only listed companies were required to appoint independent directors. The number of independent directors on the board of a listed company was required to be equal to (i) one third of the board, where the chairman of the board is a non-executive director; or (ii) one half of the board, where the chairman is an executive director. However, under Companies Act, 2013, the following companies are required to appoint independent directors:

(i) Public listed company: Atleast 1/3 of board to be comprised of independent directors; and

(ii) Certain specified companies that meet the criteria listed below are required to have atleast 2 independent directors:

- Public companies which have paid up share capital of INR 100,000,000 (Rupees one hundred million only);
- Public companies which have turnover of 1,000,000,000 (Rs. one billion only); and
- Public companies which have, in the aggregate, outstanding loans, debentures and deposits exceeding INR 500,000,000 (Rupees five hundred million only)

**b) Qualification criteria**:

(i) Companies Act, 2013 prescribes detailed qualifications for the appointment of an independent director on the board of a company. Some important qualifications include:

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

(ii) Companies Act, 2013 also sets forth stringent provisions with respect to the relatives of the independent director.

**Key Removals:** It is evident from provisions of Companies Act, 2013 that much emphasis has been placed on ensuring greater independence of independent directors. The overall intent behind these provisions is to ensure that an independent director has no pecuniary relationship with, nor is he provided any incentives other than the sitting fee for board meetings by it in any manner, which may compromise his/her independence. In view of the additional criteria prescribed in Companies Act, 2013, many listed companies may need to revisit the criteria used in appointing their independent directors.

**c) Liability of independent directors**

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

**Key Removals.** Companies Act, 2013 proposes to empower independent directors with a view to increase accountability and transparency. Further, it seeks to hold independent directors liable for acts or omissions or commission by a company that occurred with their knowledge and attributable through board processes. While Companies Act, 2013 introduces these provisions with a view of increasing accountability in the board this may discourage a lot of persons who could potentially have been appointed as independent directors from accepting such a position as they would be exposed to greater liabilities while having very limited control over the board.

**COMMITTEES OF THE BOARD:**

Companies Act, 2013 envisages 3 types of committees to be constituted by the board:

**a) AUDIT COMMITTEE**: Under Companies Act, 1956, public companies with a paid up capital in excess of INR 50,000,000 (Rupees fifty million only) were required to set up an audit committee comprising of not less than 3 directors. Atleast 1/3rd had to be comprised of directors other than Managing Directors or Whole Time Directors. Companies Act, 2013 however, requires the board of every listed company and certain other public companies to constitute the audit committee consisting of a minimum of 3 directors, with the independent directors forming a majority. It prescribes that a majority of members, including its Chairman, have to be persons with the ability to read and understand financial statements. The audit committee has been entrusted with the task of providing recommendations for appointment and remuneration of auditors, review of independence of auditors, providing approval of related party transactions and scrutiny over other financial mechanisms of the company.

**b) STAKEHOLDERS RELATIONSHIP COMMITTEE**: Companies Act, 1956 did not require a company to set up a stakeholder's relationship committee. The Listing Agreement required listed companies to set up a shareholders/investors grievance committee to examine complaints and issues of shareholders. Companies Act, 2013 requires every company having more than 1,000 shareholders, debenture holders, deposit holders and any other security holders at any time during a financial year to constitute a stakeholders relationship committee to resolve the grievances of security holders of the company.

**c) CORPORATE SOCIAL RESPONSIBILITY COMMITTEE**: Companies Act, 1956 did not impose any requirement on companies relating to corporate social responsibility. Companies Act, 2013 however, requires certain companies to constitute a Corporate Social Responsibility Committee, which would be responsible to devise, recommend and monitor Corporate Social Responsibility initiatives of the company. The committee is also required to prepare a report detailing the Corporate Social Responsibility activities undertaken and if not, the reasons for failure to comply.

**Key Removals:** Companies Act, 2013 sets out an advanced framework for board functioning by division of core board functions and their delegation to committees of the board. While the audit committee and the nomination and remuneration committee provide the back end infrastructure for boards, the stakeholder's relationship committee and Corporate Social Responsibility Committee have been entrusted with the task of interaction with key stakeholders. Irrespective of their function, each of the committees would act as a 'check and balance' on the powers of the board, by ensuring greater transparency and accountability in its functioning.

**BOARD MEETINGS AND PROCESSES**

The key changes introduced by Companies Act, 2013 with respect to board meetings and processes are as under:

- First board meeting of a company to be held within 30 days of incorporation;

- Notice of minimum 7 days must be given for each board meeting. Notice for board meetings may be given by electronic means. However, board meetings may be called at shorter notice to transact “urgent business” provided such meetings are either attended by at least 1 independent director or decisions taken at such meetings on subsequent circulation are ratified by at least 1 independent director.
- Requirement for holding board meeting every quarter has been discontinued. Now at least 4 meetings have to be held each year, with a gap of not more than 120 days between 2 board meetings.
- Certain new actions have been identified, that require approval by directors in a board meeting. These include issuance of securities, grant of loans, guarantee or security, approval of financial statement and board’s report, diversification of business etc.
- Approval of circular resolution will be by a majority of directors or members who are entitled to vote on the resolution, irrespective of whether they are present in India or otherwise.

**REGULATORS**

**I. NATIONAL COMPANY LAW TRIBUNAL AND APPELLATE TRIBUNAL**

The 2013 Act replaces the High Court with a Tribunal to be known as National Company Law Tribunal (NCLT), which will consists of Judicial and Technical members, as Central Government may deem necessary, to exercise and discharge the powers and functions conferred by the 2013 Act. Appeals from the Tribunal shall lie with the National Company law Appellate Tribunal and an appeal arising out of order of NCLAT on any question of law shall lie to Supreme Court.

**II. SERIOUS FRAUD INVESTIGATION OFFICE (SFIO)**

The Companies Act, 2013 provides legal status to Serious Fraud Investigation Office under Ministry of Corporate Affairs. SFIO will consist of experts from various relevant disciplines including law, banking, corporate affairs, taxation, capital market, information technology and forensic audit. The central government may assign investigation into the affairs of a company to SFIO:

- on receipt of a report of the registrar or inspector,
- on intimation of a special resolution passed by a company that its affairs are required to be investigated,
- in public interest, or
- on request from any department of the central government or state government.
- Investigation report of SFIO filed with the Court for framing of charges shall be treated as a report filed by a Police Officer.
- SFIO will have the power to arrest in respect of certain offences, which attract the punishment for fraud.
- If any case has been assigned by the Central government to SFIO for investigation, no other investigating agency will proceed with investigation in such cases.
- Stringent penalties are prescribed for fraud-related offences.

**Key Removals:** In the backdrop of global corporate transactions, the changes relating to participation of directors by audio visual and electronic means are a welcome step, aimed at keeping pace with technological advancements.

## CONCLUSION

Companies Act, 2013 has introduced noteworthy changes regarding the board composition and has a renewed focus on board processes. Whilst certain of these changes may seem overly prescriptive, a closer analysis leads to a compelling conclusion that the emphasis is on board processes, which over a period of time would institutionalize good corporate governance and not make governance over-dependent on the presence of certain individuals on the board. The Act is a progressive and forward looking which promises improved corporate governance norms, enhanced disclosures and transparency, facilitation of responsible entrepreneurship, increased accountability of company managements and auditors and stricter enforcement processes. It goes a long way in protecting the interests of shareholders and removes administrative burden in several areas. The introduction of Corporate Social Responsibility as an integral function of corporate operations is the most significant step and also the levy of heavier penalties for transgressions from fulfillment of its obligations. Overall, the Act promises to significantly raise the bar on Corporate Governance and will radically alter the framework in a positive sense.

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