

## DIRECTORS OF COMPANY AND THEIR ROLE IN FORTIFICATION OF CORPORATE GOVERNANCE NORMS IN INDIA

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### ***Abstract***

*Corporate governance is a set of rules through which a company is administrated. Good corporate governance practices protect the interest of investor and other stakeholders of company and having impact on economic growth of nation. It establishes investor confidence and attracts investment from national as well as international investors. Directors are playing pivotal role in enhancement of good corporate governance. This study analyzes the need, evolution and role of directors in fortification of corporate governance norms in India. Further it deals with the steps taken by the regulatory authorities to strengthen the norms.*

*Key Words: role of directors, corporate governance*

### **Introduction**

Corporate governance is a set of rules through which a company is administrated. “Corporate Governance is the application of best Management Practices, Compliance of Laws 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.”<sup>2</sup> Corporate governance balances the interests of many stakeholders of

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<sup>1</sup> Defined by Institute of Company Secretaries Of India (ICSI). It is a statutory body established under the Company Secretaries Act, 1980.

company, such as shareholders, management, customers, suppliers, bankers, government and the society. Generally, Memorandum of Association and Articles of Association of company comprise corporate governance norms. Apart from those, certain other norms have been prescribed by the Companies Act regulator the Ministry of Corporate Affairs (MCA), the securities market regulator Securities and Exchange Board of India (SEBI) and the Reserve Bank of India. Companies are having primary obligation to fulfill all those rules and norms without fail.

### **Need of corporate governance**

Good corporate governance practices protect the interest of investor and other stakeholders of company and having impact on economic growth of nation. It establishes investor confidence and attracts investment from national as well as international investors. Foreign Institutional Investors' (FII) investment in the capital market and Foreign Direct Investment (FDI) in joint ventures with companies are depends upon good governance practices. Better governance is considered as an important means for redressing investors' grievances.

Absence of good corporate governance leads to corporate failure. Many corporate giants like Enron, World Com in United States, Bank of Credit and Commerce International (BCCI) and the Maxwell in England and Satyam, Pyramid Saimira Theatre Limited (PSTL), Ranbaxy, Nagarjuna Finance Ltd and Sahara India Ltd in India collapsed due to lack of transparency and disclosures and instances of falsification of accounts. Failures of these multinational companies bring out the importance of good corporate governance structure.

### **Evolution of Corporate Governance norms**

Companies Act regulator and the securities market regulator are having pivotal role in the enhancement of corporate governance norms. Indian company law has been containing those norms in its various provisions. Recently, the companies Act 2013 has included some new concepts like appointment of independent directors, disclosure of related party transaction, whistle blower policy, stakeholder relationship committee and constitution of nomination committee to strengthen corporate governance standard according to the need of corporate world.

In 1996, the Confederation on Indian Industry (CII) taken first initiative on corporate governance and constituted a task force headed by Mr. Ragul Bajaj, former president of CII. After that the SEBI constituted Kumar Mangalam Birla Committee in 1999. Based on the recommendations of the Birla committee report, the SEBI inserted a clause 49, in the name of corporate governance in its Listing Agreement and sent to all stock exchanges through a circular on February 21, 2000.<sup>3</sup> The SEBI has revised this clause several times and incorporated some new clauses and sub-clauses based on the Naresh Chandra and Narayana Murthy Committees constituted by the SEBI. Recently the Clause 49 was revised and circulated<sup>4</sup> on April 17, 2014 by the SEBI in accordance with the new Companies Act 2013. As per the revised clause the concept of corporate governance has been divided in to eleven parts namely Ensuring the rights of shareholders, Board of Directors, Audit committee, Nomination and Remuneration Committee, Subsidiary companies, Risk Management, Related Party Transactions, Disclosures, CEO/CFO certification, Report on corporate governance, Compliance of the clause.

### **Role of Directors**

Each and every company has statutory requirement to comply the above mentioned corporate governance norms. Especially all listed public companies have been mandated by the regulatory authorities of the securities market and corporate affairs to comply and disclose the essentials. Being an artificial person, a company cannot act itself and it needs natural persons to administer the day to day affairs of the company. Directors are that natural persons who administer company. Group of directors of company are collectively called Board of directors. They are having fiduciary duty to fulfill all the above requirements prescribed by the authorities. Directors are playing pivotal role in enhancement of good corporate governance. Key functions of the directors are,<sup>5</sup>

- To review and guide corporate strategy, business plans, risk management policy, annual budgets.
- To set goals of corporate overall performance, tracking and implementation of the performance.
- To supervise major capital expenditures, acquisitions and disinvestments.

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<sup>3</sup> SEBI's circular, SMDRP/POLICY/CIR-10/2000

<sup>4</sup> SEBI's circular, CIR/CFD/POLICY CELL/2/2014

<sup>5</sup> Clause 49 (I) (D) (2) of SEBI Equity Listing agreement circulated on April 17, 2014

- To implement the corporate governance norms and policies effectively, monitor the effectiveness of the company's governance practices and to make changes as needed.
- To select, compensate, monitor and, while important, replace key executives and to supervise succession planning.
- To align key executive and board remuneration with the longer term interests of the company and its shareholders.
- To ensure a transparent board nomination process with the diversity of thought, experience, knowledge, perspective and gender in the Board.
- To monitor and manage potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions.
- To ensure the integrity of the company's accounting and financial reporting systems, and compliance with the law and relevant standards.
- To oversee the process of disclosure and communications.

### **Appointment, reappointment, removal and remuneration of Directors**

Generally, directors are appointed by the shareholders through resolution passed at the general meeting. After completion of their office duration they may be re appointed to the Board according to the discretion of majority shareholders. A director may be removed from his/her office by an ordinary resolution passed by shareholders at any time before the expiry of the period of office after giving a reasonable opportunity of being heard.<sup>6</sup>

### **Fortification of corporate governance through Directors**

Ministry of Corporate Affairs, Securities and Exchange Board of India and other related authorities have taken following steps to strengthen the corporate governance standard in India. Maintaining standard of corporate governance is one of the most important duties of Board. Being brain of the company, the Board needs independence to do their business without any control. To ensure the independence of Board, the above mentioned regulatory authorities mandate to appoint independent directors

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<sup>6</sup> Sections 152 and 169 of Companies Act 2013

## **Composition of Board**

The companies Act 2013 prescribes that, one-third of the Board of listed public companies must be independent directors<sup>7</sup> where as the SEBI mandated that, half of the Board shall be independent directors if the chairman of the Board is an executive director or one third of the Board shall be independent directors if the chairman of the Board is a non-executive director.<sup>8</sup> After constitution of Board with such combination, the members of the Board have been involved in various committees.

## **Constitution of Board Committees**

The companies Act requires to constitute Audit committee with majority of independent directors<sup>9</sup> and it shall be headed by the independent director.<sup>10</sup> The committee recommends appointing auditors, remuneration and their terms of appointment. It review and monitor the independence and performance of auditors and effectiveness of audit process. Furthermore, directors are being members of Nomination and Remuneration Committee. This committee consists three or more non-executive directors out of which not less than one-half shall be independent directors. It identifies the right and qualified person to become member of Board and carry out evaluation of such members' performance. The Stakeholders Relationship Committee which considers and resolves the grievances of securities holders of the company also consist a non-executive director as chairperson and directors as members.<sup>11</sup> Board of company is responsible to frame, implement and monitor risk management plan. To manage such risk the Board constitutes risk management committee by its members.

## **Whistle Blower Policy**

The companies require setting up a vigil mechanism for directors and employees to file concerns about unethical behavior, real or suspected fraud or violation of the code of conduct of company or ethical procedures. This mechanism needs to provide sufficient safeguards to whistle blowers who avail of the mechanism and additionally provide for direct access to the chairman of the audit committee in exceptional circumstances. The details of

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<sup>7</sup> Section 149 of the Companies Act,2013

<sup>8</sup> Clause 49 (II) (A) of SEBI Equity Listing agreement circulated on April 17, 2014

<sup>9</sup> Section 177(2) of the Companies Act,2013

<sup>10</sup> Clause 49 (III) (A) (3) of SEBI Equity Listing agreement circulated on April 17, 2014

<sup>11</sup> Section 178 of the Companies Act,2013and Clause 49 (IV) of SEBI Equity Listing agreement

such mechanism established shall be disclosed by the company on its website and in the report of Board.<sup>12</sup>

### **Report on Corporate Governance**

A quarterly compliance report of companies must be submitted to the stock exchanges within fifteen days from the close of each quarter. At the end of the financial year, separate section for reporting corporate governance compliance shall be attached at the annual report of company. If company didn't comply any mandatory requirement, the company shall specify the reasons for such non compliance.

### **Educatory mechanism**

Transparency and disclosure are important features of good corporate governance. At the same time share holders are having right to question at the right time. The Central government has established Investor Education and Protection Fund to educate investors and to promote investor awareness and protection. On 2003 the MCA set up National Foundation for Corporate Governance (NFCG) in partnership with Confederation of Indian Industry (CII), Institute of Company Secretaries of India (ICSI) and Institute of Chartered Accountants of India (ICAI). The ultimate aim of NFCG is to promote good Corporate Governance practices both at the level of individual corporate and Industry as a whole.

### **Conclusion**

Directors are serving in the above said committees in various capacities and through that they strengthen corporate governance norms. Directors are the guardian of the corporate governance. They shall be free from all control to do their business without any restriction. But the majority shareholders are having various means *i.e.*, appointment, reappointment, removal and remuneration to control the directors including independent directors. It affects the ultimate objective of appointment of independent directors. Domination of controlling majority shareholders will deviate the fulfillment of corporate governance norms. Non fulfillment of such norms will definitely undermine the investor confidence and it will lead the investors to withdraw their investment from the securities market.

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<sup>12</sup> Section 177(9) and (10) of the Companies Act,2013