

Companies Act and Corporate Governance in India: Quo Vadis?

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ABSTRACT

The theoretical framework of the paper draws from institutional economics and conceptual framework of corporate governance is derived from incomplete contract among various stakeholders in a firm. Three institutions stand at the center of a capitalist economy: private property, markets, and the Rule of Law. Capitalism depends on the Rule of Law to prohibit coercion and fraud. Without the Rule of Law, long-term agreements and contracts cannot be provided by market, because people could not be prevented from dealing dishonestly with each other. It is in this context, we set out to examine critically evaluate the present form of Companies Act and its implications for corporate governance. The paper analyses certain provisions in the Companies Act 2013 that will improve corporate governance by reducing conflicts at various levels. However, certain problem areas remain. They include incorporation of clause 49 in the Articles of Association, developing and incorporating company policy specific provisions under the model of corporate governance, fully independent audit committee, appointment of chief ethics officer, setting up independent committee on corporate governance issues, rotation of external auditors, number of independent directors, significant reduction in the number of companies of which a person can be director.

Keywords: Corporate governance, Companies Act 2013, Institutional economics

1.0 Introduction

North (1991) defines institutions as constraints on behavior imposed by “the rules of the game” in society: “Institutions include any form of constraint that human beings devise to shape human interaction.”

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Three institutions are at the cornerstone of a capitalist economy: private property, markets, and the Rule of Law¹. We need property rights to write contracts, bankruptcy laws and courts to enforce the contracts in the context of impersonal exchange and market to coordinate decisions regarding investment, production and distribution. Capitalism depends on the rule of Law to prohibit coercion and fraud. Without the Rule of Law, long-term agreements and contracts cannot be provided by market, because people could not be prevented from dealing dishonestly with each other. Thus the qualities of the legal system and of law enforcement providing for impersonal exchange constitute the foundation of the market. However, they have to be preceded by formulation and enactment of appropriate laws. A dispassionate debate about all the aspects of the Companies Act 2013 needs to be conducted so that a near optimal company law may emerge producing the right legal foundation for the evolving market economy. An appropriate legal foundation will permit the market to conduct more mutually beneficially exchanges to produce wealth with resources hitherto underemployed labour force and fixed or changing technology². Such exchanges, needs to be preceded by production of new goods and services. It will lead to employment of more manpower and the value added created in the new ventures will justify such employment, in case of unemployed labour, typical of any developing economy. In case of a fully employed economy, the opportunity cost of employing labour will have to justify by the exchange value of new products and services. Production of services by information technology industry requires new technology, requiring new rules of the game for stable interaction between

¹Rule of law is defined by the presence of a centralized authority capable of exacting coercive penalties for violations of legal rules. (Hadfield and Weingast , 2011)

² A very recent example relating to adverse impact of appropriate regulation on functioning of a market economy is produced here. In the latter part of 2010, the National Spot Exchange Ltd, emboldened by the absence of strict regulatory oversight, expanded its operations to include 'novel products'. Punters joined in steadily to take advantage of the new 'services' NSEL offered, which included paired contracts of T+2/T+25. Despite whispers of unauthorised deals, including those struck for the above paired contracts, punters felt safe to do business because of the lack of regulation.

provider and user. Allowing private sector to actually produce goods and services not allowed earlier (banking, insurance and airlines as occurred recent times) needs to be preceded by enactment of suitable laws³. Allowing trade in distressed debt and pollution created by firms neither requires any new production to precede such neither trade nor new technology. Hence new law to generate more marketable output and wealth may or may not need new technology.

Till the new law is in force, the legal foundation remains suboptimal, adversely impacting the function of market to create wealth in a market economy. If the legal foundation is slow to respond to the requirements of the market economy, it creates dis-equilibrium between the demand for new rules for functioning of the market and supply of such rules by political authority leads to an adverse impact on the functioning of the market economy. For example, Narasimham Committee suggested creation of ARC (Asset Reconstruction Company) to tackle the problem of Non-Performing Assets in Public Sector Banks way back in 1991, but the required legislation in the form of the SRFAESI Act was enacted as late as in December 2002. In the meantime, crores of Rs remained locked in the form of NPAs of public sector banks, giving rise to demand for recapitalization. Clearly, slow change in the legal framework cripples market economy by disallowing mutually profitable exchange in market adversely influencing creation of wealth and consequently forcing the economy to remain stuck in a Pareto-inferior situation.

It needs to be pointed out the rules of the game become sub-optimal in multiple ways. As agents discover loopholes in existing laws, and learn to behave opportunistically to cheat other while transacting in market, the existing laws degenerate into incomplete contract between economic agents, raise chance of litigation and lead to wastage of resources and a crippling market economy. Thus, while new laws to be enacted to permit exchanges not hitherto permitted, old laws constantly needs to be reviewed. With the above backdrop, we intend

³ While changes in laws will permit private players to enter new areas reserved for public sector, the actual entry new private players may be facilitated by emergence of new technology. The new private players may not enter unless they have the benefit of a better technology to cope up with large public sector incumbents. While enactment of new laws is a necessary condition for actual production by new entities, it is not a sufficient condition for market to support more production and exchange through entry of new private players.

to critically examine the evolution of the present form of Companies Act and analyse its implications for corporate governance.

The plan of the paper is as follows: Section II examines a few traditions in economics and ultimately draws from institutional economics to develop the theoretical framework of the paper and a conceptual framework to analyse corporate governance. It also provides a conceptual framework of corporate governance. Section III provides the historical background of the paper and looks into the drivers of change in the corporate legal arena. Section IV brings out the positive features of the current Companies Act and analyses how they will lead to improved corporate governance through reduction in conflicts at various levels. Section V points out the areas missed out that should have been incorporated in the final draft of the act. Section VI provides summary and conclusions.

2.0 Theoretical and Conceptual Framework

In this section, economic theories in various persuasions are examined so as to derive clues about what drives legal change in a society. Two varieties of economic theory are discussed: neoclassical and institutional.

Neoclassical Economics takes law, technology and tastes as parameters in its analysis of firm and market. However, if one is allowed to introduce a legal change in the neoclassical tradition, which permits the market to undertake more mutually beneficial transactions between agents to create wealth in the economy. As an example, one may cite introduction of a new law permitting trading of pollution rights among over-polluting and under-polluting firms. In such a case, under-polluting firms may exchange their surplus with firms having a deficit and generate wealth. Interestingly creation of wealth through exchange not permitted earlier appears possible in the face of unchanged technology. Thus it is possible to adapt neoclassical theory to explain the beneficial impact of legal change on the economy in a situation of fixed technology, while the paradigm remains clueless about drivers of change in legal foundation of the market economy. It may be adapted to explain the impact of legal change and not what causes it.

A near optimal legal structure becomes sub-optimal as circumstances change. But without a coordinating device, such as legislation or the appearance of a “political entrepreneur”, to engineer a change in the rules, the economy

might remain stuck in a sub-optimal equilibrium. Commons argued that if existing rules became unsuitable then individuals or groups would attempt to change them through the courts or by legislation. Alston (1996) outlines the general framework: “Institutional change can be thought of as the result of supply and demand forces in a society. We can think of demanders as constituents and suppliers as the government ... Institutional change results from the bargaining actions of demanders and suppliers.”

Having outlined the broad theoretical framework, one needs to discuss the concept of corporate governance to be used in the study. Corporate Governance may be defined as a set of systems, processes and principles, which ensure that a company is governed in the best interest of all stakeholders. It needs to be clarified that different stakeholders have competing claims on a firm and are always not bound by a complete contract among themselves⁴. Hence it is very natural that conflicts arise between different stakeholders while the firm operates (Murthy, 2011, Deb and Murthy, 2011). To be specific, conflicts arise at multiple levels between:

- Shareholders and managers (conflict between profit and growth)
- Regulator and shareholders (in the event of shareholders flouting regulations)
- Regulator and manager (in the event of loose regulations)
- Shareholders and debt holders (different perceptions related to risk taking)
- Majority shareholders and minority shareholders (relating to strategic decision making)
- Multiple majority shareholders (for control of the firm)
- Shareholders and society (short term interest of the shareholders and long term interest of society)

The above conceptual framework will be employed in the rest of the paper to explore the implications of the managing agency system in the regulated era as well as the provisions of the company’s act in the deregulated era for corporate

⁴ The existence of incomplete contracts is what makes corporate governance distinct from contractual governance (Zingales, 1998).

governance. It will be also used to evaluate the suggestions made later in the paper to improve corporate governance.

3.0 Historical Background and the Drivers of Change in the Corporate Legal Arena

The colonial rule brought forth the application of the British corporate laws in the form of Companies Act, 1913 and its amended version in 1936. After gaining freedom, the Companies Act, 1956 was passed. The Companies Act, 1956 was a consolidating legislation of monumental proportions having wide reaching implications which significantly altered the structure of corporate management in India. It severely restricted functioning of managing agency system in the country. The institution of managing agency was set up to offset scarcity of capital during the colonial rule. These were effectively partnerships between European business houses and Indian entrepreneurs. The former provided seed capital and management expertise to set up companies and factories; the latter ran the enterprises and repatriated a part of their profits as specified in the contract. Management agencies had helped create new companies in India since the late 18th century and continued to do so after independence as well. However, as capital became more freely available, the case for management agencies weakened and the institution outlived its importance. The Indian managing agents started taking away a larger share of the profits. This led to a conflict of interest between ordinary shareholders and managing agents. Abolition of the managing agency system appeared to be a pre-requisite to the rationalisation of the corporate structure of these entities and was scrapped in the 1970s. To sum up, an institution which helped industrialisation in the context of scarcity of resources in the colonial period needed to be legally discarded so that it cannot be manipulated for siphoning corporate wealth through opportunistic behaviour of agents.

As loopholes were observed in practice of the Companies Act, 1956, amendments were made to plug these loopholes in the later part of twentieth century. The Companies (amendment) Act, 1999 was prompted by the objective of rejuvenating the capital market by boosting morale of business houses and encouraging Foreign Institutional Investment and Foreign Direct Investment in

the wake of the new policy. This was followed by the companies (amendment) Act, 2000, which sought to ensure meaningful shareholders democracy in the functioning of the companies. These apart, a working group were appointed to examine the subject of on corporate excellence through corporate governance and submitted its report in November 2000. Joshi Committee, constituted in 1997, with a view to have a fresh look at Company's bill submitted its report in September 2002.

So far we have been talking about amendments to Companies Act, 1956. In addition, SEBI has extensive powers to issue directions to market participants relating to corporate governance, under SEBI Act, 1992. A few such regulations include: the SEBI (Insider Trading) Regulations, 1992; SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities market Regulations, 1995, SEBI (Substantial Acquisition of Shares and takeover) Regulation, 1997; SEBI (Disclosure and Investor Protection) Guidelines, Regulations, 2000.

There occurred incremental legislations in the form of amendments to from time to time to accommodate the demand for legal change as the economy progressed. In the meantime, corporate sector in the country expanded drastically from 30000 approximated as in the year 1956 to 8, 21,212 approximately in 2009. Exponential growth of the Indian economy in the context of a changing national and international economic environment, changes in the stakeholders' expectations, and emergence of corporate form of organization as the preferred vehicle for commercial activity with large scale mobilization of resources from the public set the tone for a major overhaul of Companies Act, 1956. Impact of such drastic changes on law can not be accommodated by amendments to Companies Act, 1956, which had a controlled economy is its background. While need for change in corporate law was naturally felt as the economy was going through a process of change, such a need became more acute with the onset of a major crisis, unparalleled In Indian corporate history. A prominent IT company Satyam, recipient of awards for outstanding corporate governance collapsed in 2009. The Satyam saga has shattered the dreams of all stakeholders including government, regulators, investors and creditors' shareholders government. The emergence of this exceptional crisis led to questioning the role of independent directors, audit committee's decisions, responsibilities of internal as well as

external auditors, accounting practices of statutory auditors, professional management functions, and the role of the government.

The Companies Bill constitutes the starting point of the process of legal change in the corporate arena. The Companies Bill was introduced by the Government in the Lok Sabha on 23rd October, 2008 as “Companies Bill 2008”. The said Bill lapsed automatically on the dissolution of Lok Sabha in terms of Article 107(5) of the Constitution of India. The Bill was again introduced by the Government in Lok Sabha as “Companies Bill, 2009” on 3rd August 2009 and was referred to the Hon’ble ‘Standing Committee on Finance’ on 9th September 2009 for examination. The Committee took the representations of Ministry of Corporate Affairs at various sittings held between September 2009-July 2010. The Committee also heard the views of representatives of FICCI, CII, ICAI, ICSI, ICWAI, SEBI, RBI, Indian Banks Association and various other associations and regulators. The Hon’ble Parliamentary Standing Committee adopted its report on 26 August, 2010 and placed the same before Lok Sabha on 31st August, 2010. Currently it is passed by the parliament and is awaiting approval of the president. The new Companies Act is highlighting the lots of positive move towards the better corporate governance such as First Director, Key Managerial Personnel, E-Governance Initiatives, modified concept of independent director, definition of promoters, formulation of Corporate Social Responsibility and its disclosure in the Annual Report, restriction on public deposits, define the role of auditors and directors etc. The study suggests the concept of 100% independent audit committee, making clause 49 as the mandatory part of companies article of association (AOA), independent regulatory panel to monitor auditors, reduction of number of companies (of which a person can be director), limit on the independent directors’ tenure, review the definition of independent director given in clause 49, rotation policy for external director, introducing the concept of ethical code for maintaining transparency, proper review of internal auditors job by external auditors, mandatory of cost audit, proper implementation of audit standard and IFRS, etc., need to be reflected upon.

4.0 Companies Act and Corporate Governance: A Critical Review

The need of a legal framework was felt to enable the Indian corporate sector to adopt the best international practices in a globally competitive manner, fostering a positive environment for investment and growth. The present section of the paper is divided into two parts. The first part deals with the amendments in the Companies Act 2013 with a close look towards corporate governance issues, whereas the second part will highlights the major recommendation that should have been included in the new Companies Act, 2013.

41. Amendments in the Companies Act

The positive outcomes of the Act are as follows.

First Director

Companies Act 2013, for the first time specify that if no provision is made in the articles of a company for the appointment of the first director, the subscribers to the memorandum who are individuals shall be deemed to be the first directors of the company until the directors are duly appointed and in case of a One Person Company an individual being member shall be deemed to be its first director until the director or directors are duly appointed by the member in accordance with the provisions of this section. In the existing Companies Act, the focus on the individual is missing. The provision for the first director incorporate the term all subscribers as the eligible person. The term subscriber includes individual, body corporate, artificial person, firm, etc.

E- Governance Initiatives

Companies Act, 2013, has included a mandatory provision for a company to go for e-governance provision for the betterment of governance. The provision about e-governance consist the following matters:-

1. Circulation of financial statements electronically and placing on company's website.
2. Existing provisions on mandatory electronic registry (MCA 21) retained.
3. Notice of meetings may be sent by electronic mode.
4. Voting by electronic mode at the meeting permitted.

5. Dividend may be paid electronically.
6. Books of accounts may be kept in electronic mode.
7. Participation of directors in Board meeting by means of video conferencing or other electronic means capable of recording and storing the proceedings allowed.

Concept of Key Managerial Personnel

First time Companies Act 2013 has coined a new concept of Key-Managerial Personnel. The purpose of the concept is to include new players in the area of responsibility zone. The term Key Managerial Personnel means-

- The Managing Director, the Chief Executive Officer or the Manager or a whole time director or directors (if there is no MD/Manager);
- The Company Secretary; and
- The Chief Financial officer;

In the new concept of KMP, the terms 'CEO' and 'CFO' have been introduced first time in the corporate business.

The provision about KMP shall consist of the following

1. Companies belonging to such class or description of companies as may be prescribed shall have whole time KMP.
2. Every KMP shall be appointed by a Board resolution.
3. If there is any vacancy in any of these posts, it should be filled within a period of 6 months.
4. Each KMP is liable as 'officer who is in default'.

Concept of Independent Director

The Act prescribes every listed public company to have at least 1/3rd Independent Directors on the Board. Central Government may prescribe the minimum number of (Independent Directors) IDs in case of other public companies and subsidiaries of any public company. There is also the provision that independent director has to be appointed in the general meeting. The independent director is not entitled to remuneration except sitting fees and commission on profits.

The Parliament Standing Committee (PSC) has given few recommendations on the independent director. As per the PSC, a panel or data bank may be maintained by MCA, out of which independent director may be appointed by the company. Like a Director Identification Number, a code for independent directors shall be provided. The Tenure of Independent director shall be 5 years. The committee has also pointed out that IDs should not have any pecuniary relationship with the company. As far as the process of appointment is concerned, Central Government (CG) shall prescribe their mode of appointment, qualifications, extent of independence, roles and responsibilities and liabilities.

Promoters

The Act defines the term promoter to mean a person, who has been named as such in a prospectus and who controls over the affairs of the company directly or indirectly. PSC in its report recommended including promoters in the definition of ‘officer who is in default’. This definition recognizes “indirect control” over affairs of the company. This definition is principally the same as per definition given by the SEBI.

With well-defined concept of promoter in place, the entity of promoter becomes transparent and they will be obliged to perform their functions in a more transparent and hence regulated fashion.

Corporate Social Responsibility

New Companies Act, 2013, has made a mandatory provision for companies to spend a fix amount of annual average profit on some well-defined social activities. The recommendation of Parliamentary Standing Committee:-

1. Company having

- net worth of Rs. 500 crore or more, or
- a turnover of Rs. 1000 crore or more, or
- a net profit of Rs. 5 crore or more

during a year, shall formulate a CSR policy to ensure that at least 2% of its average net profits during the 3 immediately preceding financial years are spent on CSR activities.

2. Adequate disclosure to be made by the company in their Annual Report indicating company policy and specific steps taken as CSR activities.

In case any such company does not have adequate profits or is not in a position to spend prescribed amount on CSR activities, the directors would be required to give suitable disclosure/reasons in their report to the members.

Public Deposits

Companies Act, 2013 has made a few modification of the term public deposit. As per new Companies Act,

1. Acceptance of deposits from public has now been prohibited (except by NBFC and banking company)
2. Deposit can be accepted only from members.
3. Company to provide for security and deposit insurance.
4. Deposits accepted before the new Act to be repaid within one year.

PSC recommends that companies with net worth of not less than Rs.500 crore and turnover of not less than Rs. 1000 crore, may accept deposits from public subject to-

- a. Creation of charge;
- b. Obtaining high credit rating with adequate safety from recognized credit rating agency
- c. Penal interest and simpler and quicker process of providing relief to depositors in case of default

Auditors

The legislation prescribes mandatory rotation of auditors for listed companies (and such other companies as may be prescribed) where two terms of five years each have been completed by the audit firm.

Companies Act for the first time lays down the number of services that shall not be rendered by the auditor.

The services of auditor should include the core services to the exclusion of the following.

1. Accounting and book-keeping service
2. Internal audit
3. Design and implementation of any financial information system

4. Actuarial services
5. Investment advisory services
6. Investment banking services
7. Rendering of outsourced financial services
8. Management services

If any of the above exempted services are found to be rendered by the auditor, the new Companies Act had strengthened the provisions for penalty.

Such provisions include:-

- a. If the auditor contravenes any provision, he shall be punishable with fine which shall not be less than 25 thousand rupees but which may extend to five lakh rupees
- b. Where the auditor has knowingly or willfully contravened any provision, he shall be punishable with imprisonment for a term which may extend to one year and with fine which shall not be less than one lakh rupees but which may extend to 25 lakh rupees or with both.
- c. The auditor will also refund the remuneration received by him.
- d. Pay for damages to the company or to any other person for any loss arising out of incorrect or misleading statements of particulars made in his audit report.

Such a stringent provision of penalties is expected to make the auditors concentrate on their core function and promote transparency through providing true and fair view of accounting.

Audit committee

New Companies Act, 2013 has provided some clarification on the structure and duties of audit committee. The provisions are as follows:-

1. Consists of minimum 3 directors majority of whom shall be independent directors and at least one director having knowledge of financial management, audit or accounts.
2. Chairman of the committee has to be independent Director.
3. Duties of audit committee include recommending the appointment of auditors, examining financial statements and auditors' report, monitoring transactions of the company with related parties, valuation of undertaking or assets of the company, evaluating internal financial controls, etc.

4.2 Positive provisions and better corporate governance.

We use the conceptual framework of corporate governance devised in an earlier section to demonstrate that the above provisions in the Companies Act 2013 will lead to an improved scenario of corporate governance by reducing conflict at different levels.

Clarification on First Director

Existing Companies Act provided for a company/partnership firm, etc to be the first director of a newly formed company. This would result in anomalies like a company floating IPO of another company or siphoning off its funds and get away with it as it cannot be held responsible as defined under section 253 of the Companies Act. Under such situation, a company up-to the first AGM could have operated without an individual director. The new Companies Act 2013 has ruled out such possibilities where the management could have manipulated the affairs at the cost of shareholders. Thus explicit regulation providing the much needed clarification will reduce the conflict between shareholders and managers.

E- Governance Initiatives

This provision will lead to better corporate governance by leading to transparency at all levels leading to reduction in conflicts at multiple levels. For example, electronic payment of dividend, maintenance of book of accounts in electronic mode and participation of director in board meeting by means of video conferencing will ensure reduction in conflict between shareholders and managers.

Key Managerial Personnel

With the inclusion of this new concept, there will be some new players who will take the responsibility of managing the affairs of the company. All these persons who come under the preview of KMP category would be responsible and accountable for all kinds of financial transactions. This will lead to reduction in the conflict between management and different stakeholders and improve corporate governance.

Modified concept of independent director

The new Companies Act 2013 has made appointment of independent director more transparent. This will lead to better quality of independent directors, which in turn will lead to better corporate governance by reducing conflicts among stakeholders at multiple levels.

Definition of promoters

Control over a company has remained intractable so far because of absence of a definition of promoters. New Companies Act 2013, by providing such a definition has recognised indirect control over the affairs of the company. Now, the entity of promoters and its activities has become transparent reducing its chance of conflicts with other stakeholders.

Corporate Social Responsibility Activities and Disclosure

This provision has made a company more compatible with the society in which it has been operating, leading to better corporate governance. In the event of company not generating adequate profit or not in a position to spend the prescribed amount on CSR activities, the Director would be required to provide clarification. This would lead to reduction of the conflict between firm and the society and ensure better corporate governance.

Restriction on public deposits

Acceptance of public deposits in the new Companies Act 2013 has been prohibited. This ensures that an ordinary company does not come into conflict with banking and non-banking companies and concentrate on their core business activity. Moreover, acceptance of public deposits is a specialised activity which is tightly controlled and supervised by RBI. In case of problems the depositors in a bank are covered by deposit insurance and banks are supported by RBI through lender of last resort. Acceptance of public deposit will bring shareholders in direct conflict with the deposit holder. Shareholders want to earn more through undertaking risk, whereas depositors have settled for low risk free interest rate. This has made the erstwhile conflict between depositors and shareholders non-existent.

Role of auditors defined

An auditor aids the process of smooth flow of information by performing the services such as full disclosure of accounting standards, providing true and fair view of financial records, maintaining full transparency by putting records in public domain etc. It is quite important that an auditor should perform duties independently without being subject to any kind of conflict of interest. The new Companies Act 2013 enhances independency of an auditor the accountability and responsibility by isolating the auditor from activities other than auditing. This will remove the load from the auditor and lead to a situation in which the auditor will concentrate on the core area of auditing such as verification, vouching and valuation. This will lead to reduction of information asymmetry between several stakeholders and lead to better corporate governance.

5.0 Neglected Areas of Corporate Governance

In the following analysis we present some of the neglected areas that have implications for corporate governance.

(i) Incorporating the provision of Clause 49 in Article of Association

Companies should incorporate the provision of corporate governance model based on Clause 49 in their Article of Association so as to bind the Board, its Committees and all other key persons involved in the financial and other aspect of the companies. In such a case, directors are bound to perform their duties in a more regulated way. This will reduce conflict relating to management and regulation on the one hand and between shareholders and managers.

(ii) Developing and incorporating governance provision based on company ownership structure.

We can distinguish between at least two kinds of ownership structure. When the ownership is distributed between few majority shareholder and numerous minority shareholders and ownership is distributed amongst multiple shareholders with more or less similar shareholding. Corporate governance issues arise because of different reasons in these two cases. So the laws should be flexible enough to deal with corporate governance issues in both kinds of entities. For instance the provision for minority shareholders could be as follows:

“If the proportion of minority shareholders is greater than 75% the number of small shareholders director shall be, say, 2 or 3.”

Different governance structures relating to differently owned companies will take better care of typical conflicts in different cases and lead to better corporate governance issues.

(iii) Independent Audit Committee

As per section 292A of companies Act, only 2/3rd members of audit committee shall be independent directors. In order to have a clear cut transparent mechanism, there is a need to introduce 100 % independent audit committee as like the case of UK and US. Independence of audit committee in lines with UK will improve corporate governance in a preditable way.

(iv) Appointment of Chief Ethics Officer (CEO)

There is a need for the appointment of Chief Ethics Officer (CEO) in the companies for acting as a responsible person for assessing the ethical implications of the Companies Activities, assuring the ethical conduct of business and performing and delivering services to the nation in socially sound direction. This will make the firm more meaningful for society and enhance corporate governance.

(v) Set –up a committee on corporate governance issues.

There may be a regulatory committee in the companies to look after the corporate governance issues. The formation and structure of the committee should be such that members do not have any pecuniary or other interests relating to the companies. The function of such a committee shall include the verification of corporate social responsibility activities; verify the appointment of independent directors, etc. This will ensure reduction of conflict at all levels.

(vi) “Feel-Engagement Mechanism”.

After the Satyam episode, a sharp rise occurred in the number of independent directors resigning from board of listed companies. Around 115 independent directors of more than 100 listed companies stepped down between January 7 and February 7, 2009. Therefore, Companies Act 2013 should incorporate a feel – engagement mechanism amongst the independent director and corporate entity. This may be entertained by providing a fear less environment, job security mechanism, non-negative look in case of scams, etc. This again will lead to an all-round improvement in corporate governance.

(vii) Initiate Rotation of External Auditors

There is a need to go for rotational appointment of external auditors as initiated by institute of chartered accountants of India (ICAI) should be made mandatory in the upcoming bill. This will eliminate vested interest and ensure unbiased external auditing with obvious implications for corporate governance.

(viii) Need to start a quarterly review

A quarterly review of company performance by all stakeholders is needed. The present thought process endorse a conventional view on evaluating performance which is one sided. Because performance is measured only in term of profit or any other related measure. It buttresses corporate governance. It is necessary to evaluate a multi-stakeholders framework of measuring performance to ensure such a 360° performance evaluation. On its own performance will not get related to corporate governance. It gives us a rationale to incorporate a statutory multi-stakeholder/ multicriteria performance evaluation into the company law bill. A possibility is to make a Balance Score Card as an instrument for such multistakholder evaluation. The significance of this suggestion need not be overstressed.

(ix) Reduction in the number of directorship of a person.

Companies Act 2013 with a view to provide more time and attention to the directors, should consider a significant reduction of the number of company, of which a person can be director, from the current 15 to say 5 to 7. This will help unburdening directors and do justice to the job entrusted, so that agency problem will be reduced.

(x) Number of Independent Directors

The bill should take cognizance of the 'paradox of independence'. The idea behind independent director is that their behaviour should be objective. If the independent directors have 'no interest' in the company they would not be having either sufficient knowledge or motivation to be effective in intervening in the decision making process. The paradox therefore is that if the number of IDs is increased then there may be indifference. On the other hand if the number is reduced their role may be ineffective. Hence there may be a need to rethink about the appropriate number of independent directors. This suggestion has obvious implications for better corporate governance.

5.0 Summary and Conclusions

The paper looks at the rule of law as an indispensable institutional requirement for functioning of a market economy and critically analysed various aspects of Companies Act 2013 in relation to issues of corporate governance. This would help evolve an appropriate legal foundation for functioning of the market economy. The theoretical framework of the paper draws from institutional economics and the concept of corporate governance draws from incomplete contract between various stakeholders in a firm.

The paper analyses different provisions in the bill and demonstrates their significance of better corporate governance by using a conceptual framework of corporate governance based on incomplete contract amongst various stakeholders in a firm. It also provides a number of suggestions to be incorporated in the final draft. They include incorporation of clause 49 in the article of association, developing and incorporating company policy specific provision under the model of corporate governance, fully independent audit committee, appointment of chief ethics officer, setting up independent committee on corporate governance issues, feel engagement amongst independent directors, rotation of external auditors, number of independent directors, significant reduction in the number of companies of which a person can be director. The paper analyses these suggestions once again using the conceptual framework of corporate governance devised in the paper and demonstrate their significance for improving corporate governance.

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