Is India Inc resisting reforms?

As the government prepares a new Companies Bill which will, among other changes, restrict the number of layers of subsidiaries, opinion is divided on whether India Inc's opposition is justified

SUMANT BATRA

CAPPING THE NUMBER OF SUBSIDIARIES OR LIMITING THE LAYERS IN A CORPORATE PYRAMID WILL CAUSE A SERIOUS BLOW TO DOING BUSINESS WITH EFFICIENCY

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CREATION OF SUBSETS OF COMPANIES HAS CREATED LAYERS AFTER LAYERS TO SUCH AN EXTENT THAT IT IS NOT EVEN POSSIBLE TO KNOW THE REAL STRUCTURE OF OWNERSHIP

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RECENT events have put the spotlight on corporate governance practices of India Inc, sparking speculation about significant policy and regulatory steps being on the anvil to strengthen the relevant rules. India compares favourably with most other developing economies in the area of corporate governance. And Indian companies have generally been forthcoming in responding to corporate governance regulations. The new Companies Bill proposed by the Ministry of Corporate Affairs seeks to further improve corporate governance by putting greater emphasis on self-regulation, promoting a stronger and more transparent disclosure regime, and vesting greater powers in shareholders. Regulatory approvals are sought to be minimised and government control sought to be reduced. Clause 49 provides an effective framework of corporate governance for listed companies. Any attempt to increase regulation and make controls more stringent will be retrograde and unreasonable.

Capping the number of subsidiaries or limiting the layers in a corporate pyramid will cause a serious blow to doing business with efficiency. Companies forming subsidiaries for bona fide business needs should not be deprived of the ability to do this just because some unscrupulous promoters have abused the enabling provisions. This will amount to throwing the baby out with the bathwater. A company should have the freedom to determine its business structure based on business, strategic, legal, tax and other genuine considerations. Limiting such options could also be counterproductive to attracting foreign direct investment.

The concerns of policymakers can be effectively addressed by pursuing stronger regulatory oversight and exemplary enforcement. The gaps in the implementation and monitoring systems should be plugged. In comparison with developed countries that impose stringent penal and criminal penalties for poor corporate governance, penalty levels in India are considered to be inadequate to enforce good governance. Substantial penalties should be imposed for non-compliance, so that compliance is strictly observed. This will act as a deterrent for companies not observing the rules.

India Inc also needs to do more to better corporate governance and gain larger confidence amongst policymakers, regulators and stakeholders. Lack of respect for the shareholder community—and minority shareholders in particular—remains a matter of serious concern. Companies should give up their resistance to inducting minority shareholders' representatives on to their boards. Introduction of provisions enabling class actions should not be viewed as a threat. Such actions are based on an internationally recognised principle. By viewing it with suspicion, corporate India will only lose respect at the global level. Adequate safeguards against abuse of such provisions can be provided.

The very concept of independent directors has been at matter of debate. The focus has shifted from independence to quality of directors. The selection of independent directors who are known to promoter directors has only compounded the problem. Corporate India should support rules for determining processes that must underlay the selection of independent directors. It is necessary to make such processes rigorous, transparent, and objective.

Improved corporate governance cannot be achieved through increased control or regulations. Standards of corporate governance should be achieved through a mix of principle-based standards and moderate regulations. Principle-based standards should be enforced through pragmatic levels of regulations that do not stifle entrepreneurial initiatives.

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As the corporate affairs ministry seeks to dramatically and justifiedly amend the Companies Act 1956 in the pursuit of better corporate governance, the corporate world has taken an obstructionist position on various issues. While the government's move is in the right spirit, the motivations of India Inc appear murky.

Companies world over have created conglomerates through a web of complex transactions so as to achieve the objectives of diversification and growth. These kinds of structures are legally valid and may even be used for the purpose of tax planning, but beyond a point they raise serious issues. In India, the creation of subsets of companies has created layers upon layers to such an extent that it is not even possible to know the real structure of ownership. In the recent 2G scam, it has not been possible to ascertain the true ownership structure of Swan Telecom. And the vanishing companies scam initiated by CR Bhansali is a classic example of the layering device being misused. So, the need of the hour is to lay down clear-cut guidelines under the proposed Companies Bill to tackle such issues. In framing those guidelines and taking into account the ever-changing dynamics of business, there should be no prohibition against certain types of multi-level subsidiary companies or investment companies that are formed when required by a regulators.

Another issue that has been engaging the attention of the authorities is the rotation of auditors. Any move to oppose the rotation of auditors by any stakeholders, including corporates, raises serious questions. In fact, it is also not clear why certain corporates are opposing such provisions because they shall give them a lot of flexibility and independence too, in the matter of appointing auditors. In view of the large number of companies in India, it may pose a problem for all companies to implement the rotation of auditors to begin with. However, we could address this problem with a phase wise application: Phase I companies would need to implement rotation within 3 years of the new Companies Bill, Phase II companies in 4 years, and Phase III companies in 5 years. Till the time rotation of auditors is made fully operational, a joint audit may be introduced in companies having net worth of more than ₹1,000 crore.

For the first time in India, the Bill introduces the right of one or more members, or class of members or creditors, to file a class action suit. The example of class action suits filed by the shareholders in the US in the Satyam case is worth emulating. Because of the action suits, they have been able to get compensation unlike the Indian shareholders.

Independent directors are crucial as far as managing corporates and maintaining the highest level of transparency in running them is concerned. While provisions have been laid down as to the number of independent directors, meetings to be organised etc, such provisions do not have much impact. There is a lack of clarity in respect of their roles and responsibilities. There are also no clear-cut rules in respect to their remuneration. In this context, it is suggested that either Sebi or the corporate affairs ministry should take a lead role in appointing independent directors. Further, clause 49 also need to be implemented in the true spirit. Remember the role of independent directors in the Satyam fiasco, where none of the independent directors raised even a single question as to why a huge sum of cash amounting to ₹2,100 crore was lying in the company's current deposit account. In fact, a simple question from any of the independent director would have exposed the entire scam at an earlier date.

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