CORPORATE COMPLIANCES IN INDIA — Global Competitiveness through Electronic Governance

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GLOBAL COMPETITIVENESS

Information technology has been a propelling parameter for integration of all markets, globally. Harmonisation of trading practices is becoming the global order of the day, which necessitates harmonisation of regulatory practices. The advent of Internet trading and seamless settlements has been the harbinger of a new era, which is bound to culminate in negating the existence of geographic frontiers. Our corporate regulatory mechanism needs to be garbed in a new attire to enable it assimilate international thought processes and adopt an innovative legal outlook that extends beyond national bounds. E-Governance, though not a panacea for all corporate evils, plays a vital role in achieving higher levels of corporate regulatory compliances.

Need to be led by Regulatory Competition

'Doing Business 2006', a survey conducted by International Finance Corporation (IFC), the private sector arm of the World Bank Group, puts India, way down at 116 out of the 155 countries surveyed for its report. The report, which uses January 2005 data for its set of indicators, takes into account regulations and reforms using parameters such as degree of regulation, tax compliance, time and cost to enforce a contract, legal protection of property, labour flexibility, investor protection and ease of trade across borders. The regulators in India do have an occasion to be "proud" that she is twenty-five notches below China, and that Afghanistan is the only country trailing behind her, in the ***'overall ease of doing business'.***

Obtaining a licence takes the longest in India in the South Asia region. Compared to around 270 days in India, in Pakistan it takes 218 days and in Sri Lanka, 167 days. Maldives process licences in less time at 131 days. France takes the least time at 56 days, while in New Zealand and Denmark entrepreneurs face the least procedural hurdles.

Harmonisation of regulations is a natural fallout of regulatory competition. Certain regulations like corporate disclosures, accounting standards, environmental laws, etc. require stringent penal provisions and strict enforcement mechanism. On the other hand, certain protective legislations which create diffidence in - prospective regulatees, regulations which have prohibitive compliance costs involved etc., have to be reworked so as to make them more friendly. This is an optimisation approach, which will cater to natural regulatory competition.

Importance of Enforcement of Regulations

Regulations are meant to be enforced. The optimisation of regulatory impact happens only with stringent enforcement of the applicable regulations. Any system that does not enable effective enforcement of regulations defeats the very purpose of such regulation. In India, the levels of enforcement are truly low, making the penal aspects of regulations a farce. The regulatees become confident of getting away with the violations they commit. Corporate Governance suffers because of the lack of enforcement infrastructure. The stakeholders ultimately suffer because of the rampant wilful regulatory violations. The legislators, the administrators, and the judiciary have to deal with this menace hand in hand.

Restorative Justice : Compliance-oriented regulation is often aimed at providing incentives and encouragement for voluntary compliance. This concept also caters to nurturing the ability of enterprises to secure compliance through self-regulation, internal

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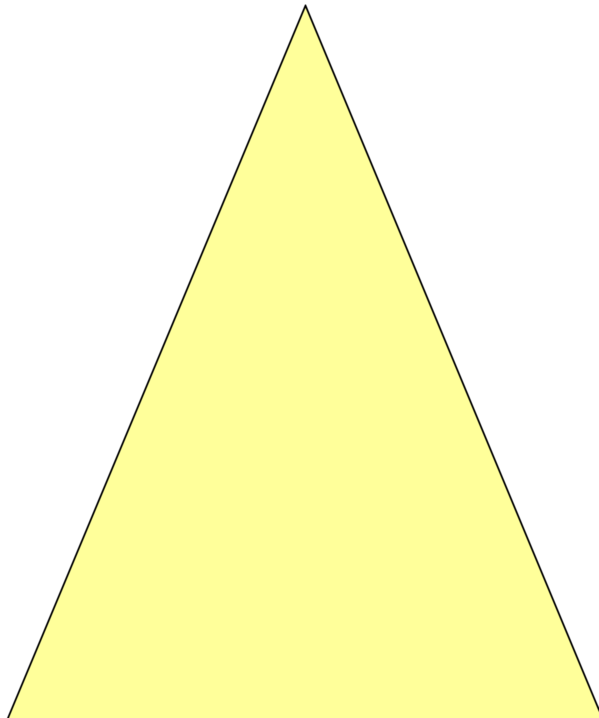
management systems, and market mechanisms wherever possible, rather than automatically using punishment for violations of the rules in the first instance. When organisations do fail to comply, a compliance-oriented regulatory approach will attempt to **restore** compliance rather than punish -Many a business regulator across the globe has successfully experimented adopting innovative mechanisms for Restorative Justice. It is therefore an important tool for regulators to use in responding to compliance failures.

Internal Corporate compliance systems are being identified as one of the best remedies against impediments to legal sanctions in permeating the internal workings of corporations. Such systems also ensure that the right person is held responsible for the wrongdoing. The corporatedom is evolving in terms of compliance with regulatory matters. Policy options, which would provide incentives or recognition for enterprises, which develop excellent compliance systems, thereby reducing the burden of routine inspections are being evaluated. Globally, some of the regulatory authorities provide penalty discounts for minor incidents of non-compliance that do occur, offer simplified licences, permit use a label or mark certifying a high level of compliance, and encourage voluntary disclosure and correction of non-fraudulent non-compliance.

(Figure 1)

Primary level:
Restorative Justice in Compliance



Responsive Enforcement : Restorative Justice, of course, must always be backed by the possibility of more punitive sanctions, against chronic defaults. This gives regulators the option of responding to wilful non-compliant corporates with harsher punitive actions. It is also imperative to make it known to the corporate world that "softer" enforcement strategies will be followed by harsher measures, in case of persistent non-compliance.

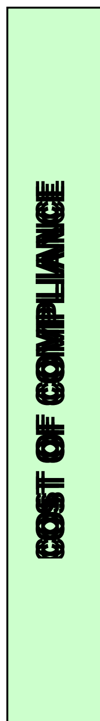
Punitive Enforcement : This term needs no explanation. (Please see Figure 1). The pyramid is a schematic representation of the idea that instead of using the most drastic regulatory strategies first, regulators should trade on the goodwill of those being regulated. Compliance is optimised by regulation, which is contingent, co-operative, tough and simultaneously forgiving. In the pyramid illustrated, suspension / revocation of licenses / registration, initiating criminal proceedings against erring persons etc., are at the top of the pyramid because they compel closing down of a business.

Cost of Compliance

A World Bank study of micro-firms in Mexico found that the average micro-firm owner faces regulatory costs that consume 17% of revenues. Because of the costs of compliance, micro-firm owners tend to operate in a way that avoids the need for compliance. While few governments have collected data demonstrating a causal link between costs of compliance and failures of compliance, studies from many OECD countries confirm that compliance costs are generally higher for SMEs, suggesting that there is a higher risk of compliance failure in this segment. A study of administrative burdens of compliance in the Netherlands in 1997 found that costs per employee of firms employing 100 or more people are just less than one-sixth of the costs for firms employing one to nine people. Similarly, in Sweden a 1997 survey found that the administrative costs of regulation "per employee" are almost four times higher for small firms than for larger SMEs. This survey also found that the bigger the firms, the more they considered that their level of compliance with regulations was high. This suggests that smaller firms are generally perceived to have lower compliance rates. Complexity, inaccessibility, and incomprehensibleness of regulations affect small business compliance rates. Many studies show that small businesses cannot keep up with the volume of regulations and regulatory guidance that is produced by many regulatory agencies.

The schematic representation below shows as to how "transparency" can be dearer:

Escalating Cost of Compliance (Figure 2)



Emerging Trends in Regulatory Compliance

The central theme of much of the current research on regulation is the idea that, in order to understand compliance, we must understand how government regulation interacts with other forms of "regulation" such as self-regulation, internal corporate management, and also with the actions of other parties such as professional groups (e.g. auditors, lawyers, safety professionals), standards-setting organisations, contractors and industry associations. In particular, scholars are using the concept of **"regulatory pluralism"** to draw attention to the fact that the state is not the only source of Regulation. This interest in looking at the different forms of Regulation, which may affect the potential targets of government regulation has lead researchers to look at the number of new areas. The new areas include the role of internal corporate compliance systems and self-regulation, the role of standards in affecting business conduct, the role of third parties as "enforcers" of policy objectives and the possibility of using incentives for compliance leadership.

An emerging area of interest for both compliance researchers and policy makers is the growth in implementation of formal regulatory compliance systems by organisations. In the US, a 1996 Price Waterhouse survey of corporate compliance practices in 262 large companies found that 86% had a formal compliance policy, 9% were developing a policy and only 5% had no policy. In Canada, a 1998 KPMG survey of corporate compliance practices found that 65% of Canada's largest companies had explicit compliance standards and procedures in place, 63% had produced publications that communicated these standards and procedures to staff and management, and 58% had assigned responsibility to high-level personnel to oversee compliance. Other studies suggest that compliance management programmes are strongest in the areas of environment, occupational health and safety, and financial services.

The implementation of corporate compliance programmes does not by itself necessarily represent an increase in levels of compliance or in optimal regulatory outcomes. Indeed, it is possible that corporate compliance systems are an expensive response to unnecessarily complex laws. Indeed one of the emerging themes of the research is the extent to which competitiveness and innovation is compatible with regulatory compliance.

Critical Evaluation of the E-Initiatives in the J.J. Irani Committee Report

Irani Committee Recommendation	*Comments*
" We feel that such preventive action should begin with registration itself and should be sustained through a regime that requires regular and mandatory filing of statutory documents. With introduction of electronic filing, this process would become convenient to companies as well as the stakeholders. Behaviour resulting in non-filing of documents or incorrect disclosures should be dealt with strictly".	It is not clear as to how facilitation of electronic filing would help eliminate the vanishing act of corporate bodies. Further, it appears that there is no move to provide for punitive action in Company Law for the promoters of Vanishing companies.
" Statutory information, which would be regulated through law, the information could also be made availablethrough other means like print, electronic media, company website etc… Use of modern technology, internet, computers, should be enabled to enhance the efficiency of the disclosure process. It should be possible to submit and disseminate financial and non - financial information by electronic means".	These recommendations are just an encouragement to use the electronic media, but do not enhance the compliance levels to meet E-Governance initiatives envisaged by the Government.
" The communication channels available to the corporates for the purpose of dissemination of information should also be augmented by allowing use of electronic media in the process of issue of capital. …Corporate issuers of capital should also be allowed to use electronic media in the process of issue of capital" .	The nature and extent of amendments that the Company law needs to facilitate this is not discussed in the report.
" With implementation of e-governance project, it should be possible to view the records of the companies filed with Registrars through electronic media. Notwithstanding this, both holding and subsidiary companies should be encouraged to make greater use of electronic media to make their published financial accounts available for viewing."	The ideal amendment to the Company Law is that an EDIFAR like database should be made mandatory for all companies, both private and public, and the same be linked to a central database encompassing Direct and Indirect Tax particulars, foreign exchange dealings, corporate borrowings etc
" The provisions under the Companies Act relating to circulation of financial statements should continue. However, the Committee recommended that the financial statements should be permitted to be sent by electronic means instead of hard copy	This is a welcome suggestion
" In the case of listed Companies, where abridged financial statements are circulated amongst members, the full financial statements should be made available on the web-site and the hard copy thereof should also be made available on request"	The existing version of these provisions under Section 217 is being grossly misused by many listed Companies and there are no measures suggested to prevent such misuses.
"The Committee also felt that a separate electronic registry should be constituted for filing schemes under Sections 391/394 of the Companies Act.	This attempt in the name of e-enabling will trigger a series of events opening a Pandora's box. The stamp duty is a state subject and as such there exist enough

Irani Committee Recommendation	Comments
Instead of filing the schemes with the Registration Offices wherever the properties of the company are located, filing the scheme with the electronic registry should be considered sufficient compliance. This however, could raise jurisdictional issues vis-à-vis Stamp Duties applicable which may be resolved by an appropriate Constitutional amendment to enable a uniform, reasonably priced Stamp Duty regime across the country. Further, there must also be a provision in the Company Law for compulsory registration with the electronic registry of all property of a company above a certain value".	and more regulatory hurdles associated with this. The moot question is that - will the Government legislate to abolish stamp duty altogether, and come out of this archaic, if not primitive revenue mechanism? How easy is this ? How far can this report persuade the Government in this direction?

E-Governance Initiatives for Corporate Compliance

The use of information and communications technologies has grown rapidly over recent years and this provides great opportunities to reduce costs and enhance the transparency of dialogue between companies and shareholders. These developments were not anticipated at the time when the majority of the provisions of the existing Company Law were evolved decades -centuries, rather - ago. The Company Law in its existing form imposes a number of requirements resulting in the use of paper, i.e., physical documents and communications. This causes avoidable expenses for companies, resulting ultimately in the erosion of the wealth of shareholders. Sensible use of information technology can enhance efficiency levels, speed and quality. Further this is totally environment friendly. The Government therefore needs to allow all companies, subject to shareholder approval, to use electronic communications with shareholders as the default option. Of course, electronic communication will not suit everyone, and individuals could be allowed to request for communication on paper if they so wish.

A major E-Governance programme on modernisation and computerisation of the Ministry of Company affairs and its field offices, in consultation with Department of IT & National Institute of Smart Governance (NISG), is being undertaken. The objective is to provide a single window interface for online registration of Companies and e-filing of documents like Balance Sheets, etc. Digital signatures and payment gateway are being built into the system.

The role of a Company Secretary also has to change with the emerging trends in technology. The modern corporates demand the Company Secretary to be highly technology savvy. According to Ms. Renu Budhiraja, Additional Director, Department of Information Technology, Ministry of Communications and Information Technology " In today's economic era of liberalization and modernisation, the Company Secretaries are required to possess a knowledge of law, management, finance and corporate governance. They *carry the image of the Company. A Company Secretary is the liaison with the outside world and with the Executives and employees within. With the advent of Information and Communication Technologies, the Company Secretary is required to have innovative interactive skills."*

E-Disclosure, an Effective Tool for Corporate Governance

Each country has its own corporate culture, national personality and priorities. Likewise, each company has its own history, culture, goals and business cycle maturity. All these factors need to be taken into consideration in crafting the optimal governance structure and practices for any country or any company. However, the influence of international capital markets will lead to convergence of governance practices. " *As regulatory barriers between national economies fall and global competition for capital increases, investment capital will follow the path to those corporations that have adopted efficient governance standards, which include acceptable accounting and disclosure standards, satisfactory investor protections and board practices designed to provide independent, accountable oversight of managers."*[1]

Corporate Disclosures play a vital role in enhancing corporate valuation. In India, there are various types of

1. Report to the OECD by the Business Sector Advisory Group on Corporate Governance (April 1998) (the Millstein Report).

corporate disclosures required to be made. They can be broadly classified into: (i) Statutory Disclosures, (ii) Non Statutory Disclosures, (iii) Continuous Disclosures, and (iv) Specific Disclosures. All these disclosures can be made in the Internet. Offer Documents for private placement of debt are required to be hosted in the website of Stock Exchanges where listing is sought. However, such hosting of prospectuses for equity issues is not compulsory. The concept of web hosting of prospectuses can be further extended to issue ***"Hyper Prospectuses"*** which will contain URL links to the respective information contained in such prospectuses. For example, if a disclosure regarding a collaboration agreement with a foreign technology partner is made in the prospectus, a URL link can be provided to the web page where the relevant information of the technology partner could be obtained.

Virtual General Meetings - A Fillip to Corporate Democracy

The Irani Committee is of the view that law should facilitate use of technology to carry out statutory processes efficiently. Meetings of the Board of Directors by electronic means (Teleconferencing and video conferencing included) to be allowed and directors who participate through electronic means should be counted for attendance and form part of Quorum. Minutes should be approved/ accepted by such directors who attended by way of teleconferencing/ videoconferencing : Signature may be accepted by use of digital signature certification. It further goes to say - *"A company should also be able to decide on remuneration to non-executive directors including independent directors. This may be in the form of Sitting Fees for Board and committee meetings attended physically or participated in electronically and / or Profit related commissions"*

If by any stretch of imagination had any one of us thought about a Virtual General Meeting? - It is being sanctified by a legal umbrage. S 192A of the Companies Act treats voting by electronic means to be at par with a postal ballot. According to chambers Dictionary poll is an aggregate of votes, the taking of a vote, taking of public opinion by means of questioning. If one can interpret the provisions of S 192A in conjunction with the provisions of the IT Act, 2000, the veil of legal infirmity for the conduct virtual general meetings appear to be lifted

Sections 11 of the Information Technology Act 2000 read with Section 12, makes it explicit that an electronic record shall be attributed to the originator (in this context, the shareholder), (a) if it was sent by the originator himself; (b) by a person who had the authority to act on behalf of the originator in respect of that electronic record; or (c) by an information system programmed by or on behalf of the originator to operate automatically. The originator can stipulate that the electronic record shall be binding only on receipt of an acknowledgment of such electronic record by him. Accordingly, the recipient (The Company) can provide the originator with the acknowledgment, and the electronic record shall be deemed to have been sent by the originator.

The suggested procedure : The meeting should be notified in the website of the company. Otherwise, an advertisement could be issued in some prominent websites. Each member should be notified through an email (email should necessarily become part of the shareholder database) regarding the convening of the General Meeting. The email should contain the URL of the page where the notice (along with the explanatory statement, if any required) and voting facility are provided. The email should also contain a system-generated password to open the registration form, allowing the member to register attendance at the General Meeting and vote. A virtual meeting need not be held on a specific time and place. It can be extended over a period of time. (meaning, there can be a starting time and date and ending time and date) The members/ beneficiary shareholders should be allowed to register for the meeting using an appropriate secured web architecture. As the members log in, the information submitted by them in the registration process will have to be verified with the database with the R&T Agent/ Depository and confirmed. To add value, the chairman's speech could also be webcast on a downloadable format. The member can raise queries through the website and the same will be replied to by the Chairman by email. The results of the voting could be displayed on a real time basis on the website itself.

Corporate Valuation, Corporate Governance and Regulatory Compliance

"Strong corporate governance is indispensable to resilient and vibrant capital markets and is an important instrument of investor protection. It is the blood that fills the veins of transparent corporate disclosure and high-quality accounting practices. It is the muscle that moves a viable and accessible financial reporting structure. Without financial reporting premised on sound, honest numbers, capital markets will collapse upon themselves. It is therefore almost a truism that the adequacy and the quality of corporate governance shape the growth and the future of any capital market and

economy."[2] Our market and the regulators need to evolve a mechanism to determine the value of corporate governance that a company carries in its Market Capitalisation (MCap). One can imagine the MCap of Infosys, minus the value it has derived from corporate governance!

The Irani report says : *"There should be recognition of principle of valuation of shares of a company through an independent valuation mechanism as means of safeguarding minority interests" … "The Law should specifically provide that a public company shall not allot shares as fully or partly paid-up otherwise than in cash, unless the consideration is independently valued by a valuer appointed by the company in consultation with the allottee and the valuation is made known to the allottee and the concerned Regulator. Committee feels that detailed provisions are also required to be provided in the Companies Act as there is a need for valuation of such non-cash consideration by independent valuers."* The Committee while discussing this aspect in detail, has also taken into account the Shroff Committee Report on "Valuation of Corporate Assets and Shares". It also recommends that valuation of shares of companies involved in schemes of mergers should be made mandatory and should be carried out by independent registered valuers rather than by Court appointed valuers.

However, these recommendations, may not address the real problem underlying the concept of valuation itself. In the context of corporate mergers happening in India under the provisions of Sections 394-396, the process of arriving at the swap ratio is far from transparent. Once a valuer is appointed by the Board of Directors of the amalgamating and amalgamated companies, the valuer arrives at the intrinsic enterprise value by adopting any or all of the generally accepted principles of valuation and then applies **"professional judgement"** This is neither the mean of the value obtained by any of the established practices, nor the market value of the assets. It has been observed that, normally, the value obtained after applying the professional judgement would be one that has no relevance to any of the value obtained by accepted practices. High Courts have been traditionally accepting these opaque valuations without going into their veracity. In the interest of the shareholders, the new Company Law needs to address this issue and prescribe appropriate norms for corporate valuations as part of the merger process.

With the capital market maturing in India, the corporate world is witnessing increased activism by the institutional investor. The concept of transparent corporate valuations attains significance in India, in this context. The pension funds in the US have fostered the greatest upsurge in institutional monitoring. *"As an investment strategy, public employee retirement funds in the mid-1980's realised that the only alternative to further enhance fund value entailed boosting corporate performance. Therefore, institutions like CalPERS (California Public Employees Retirements System) have played an important role in removing the former CEOs of IBM and General Motors"*[3] .

The creation of a truthful online corporate database which contains the entire gamut of corporate information (meaning, the balance sheet items and the off balance sheet items) reported in a transparent manner is the need of the hour, which will address the valuation blues. The database should generate its own inferences, based on pre set parameters and should arrive at the intrinsic value of the business, value of shares, and other relevant information required for corporate valuation. This value should be mandatorily reckoned with, as the basis for devising swap ratio for mergers and amalgamations.

CONCLUSION

Information Technology is a boon to mankind. All depends on how best we utilise it. If our law makers, would consider, a unified corporate law for all corporate bodies in India, discard archaic laws which enshrine statutory corporations, bringing the Securities Laws, SEBI Act and other related matters under the umbrella of Company Law, inculcate an "e-orientation" amongst the investors, encourage e-governance in all facets of corporate life, we have nothing to doubt - our corporate sector and capital markets will be the best in the world.

2 Pratip Kar Executive Director, Securities and Exchange Board of India on "CORPORATE GOVERNANCE AND THE EMPOWERMENT OF THE INVESTORS" at the 2nd Asian Corporate Governance Round Table organized by ADB/OECD/WORLD BANK.

3 CORPORATE GOVERNANCE: EFFECTS ON FIRM PERFORMANCE AND ECONOMIC GROWTH by Maria Maher and Thomas Andersson, Organisation For Economic Co-Operation And Development.