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LEGAL ASPECTS OF GROUP COMPANIES — EMERGING ISSUES

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I. INTRODUCTION

Recently, the means of doing business have come under sharp focus in the aftermath of Enron Episode and Tata-VSNL controversy. The Enron debacle and indictment of Arthur Anderson have brought into sharp focus and re-emphasised the importance of Corporate Governance, transparency, accountability and ethical practices for corporate sector. Similarly, the Tata-VSNL controversy typified the central problem of corporate governance in India, namely – the tendency of controlling groups to advance their own interest at the cost of other shareholders.

Effective corporate governance is at the core of an efficient market economy. Shareholders and other stakeholders must have access to information and the ability to influence and control management, through both internal governance procedures and external legal and regulatory mechanisms, in order to ensure that a company's assets are being utilized in the interests of all stakeholders. This is important in both developed and developing economies.

II. THE GROUP COMPANIES

Group companies in general terms may be a parent (holding) – subsidiary or brother-sister companies (co-subsidiaries) or under more complicated arrangements. The inter-relationships of a number of companies and the ways in which the parent exercises control over the business of its subsidiaries and their relationship with the outside world has been the subject of discussion in the recent past.

Groups arise in different ways. They may be founded as such. A company is incorporated to carry on business as a holding company and then proceeds to incorporate trading subsidiaries. Alternatively, a company which is a trading company may grow and convert itself into a holding company, later hiving down its trading activities into subsidiaries. Again, a group relationship may arise as a result of a takeover. One company takes over another which then becomes its subsidiary when shares have been acquired by the first company .

There are various reasons why the subsidiaries are kept in business, because they may constitute a convenient unit of management or accounting within the group. It may be to achieve forward or backward integration or there may be commercial or fiscal advantages in running one or more undertakings.

III. NATURE OF RELATIONSHIP BETWEEN GROUP COMPANIES

Separate identity of each group company is recognized i.e.

(a) the respective business transactions, accounts and records of the various group companies are not inter-mingled;

(b) the formalities of separate corporate procedures for each company are observed;

(c) each company is adequately financed as a separate unit in the light of its obligations commensurate with its size and character;

(d) the respective companies are held out to the public as separate enterprises.

The separate corporate personality can be disregarded in the absence of the aforesaid factors.

IV. TEST OF DETERMINING HOLDING – SUBSIDIARY RELATIONSHIP

Section 4 of the Companies Act, 1956 provides three fold test to determine the relationship. Test

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* Secretary, The Institute of Company Secretaries of India, The views expressed are the personal views of the author and do not in any way reflect the views of the Institute.

one i.e. sub-section (1) (a) says that a company shall be deemed to be a subsidiary of another if the other controls the composition of its Board of Directors. Test Two – i.e. sub-section (b) says that a company shall be deemed to be a subsidiary of another if that other company holds more than half in nominal value of its equity share capital/voting power. Third Test – A company shall be deemed to be subsidiary of another, if it is a subsidiary of any company which is that others' subsidiary.

V. PYRAMIDS

A group pyramid can be defined as a group structure characterized by a more or less long chain of control using several holding companies. The ultimate shareholders control each company in the chain by majority or controlling interests, leaving minority shareholders at each level. The result is that the ultimate shareholders may control the whole chain up to and including the company at the bottom on the basis of a small total investment.

Example – If the ultimate shareholders own 50% at each level, in a chain of six companies an investment by the ultimate investor equivalent to 1.56% in the capital of the company at the bottom is required to have full control. This effect is created by having minority shareholders at each level finance the controlling stake of the ultimate shareholder in the level below.

VI. INTER-CORPORATE LOANS AND INVESTMENTS-LEGAL PROVISIONS IN THE COMPANIES ACT, 1956

Provision in respect of giving loans, making investments, giving guarantee or providing securities have been considerably modified w.e.f. 31.10.1998 by inserting Section 372 A and providing that earlier Section 370 and 372 shall not apply in respect of loans/investment made or guarantees/ securities provided after 31.10.1998.

Section 372A of the Companies Act, 1956 provides that no company shall, directly or indirectly make any loan to any other body corporate; give any guarantee, or provide security, in connection with a loan made by any other person to, or to any other person by, any body corporate; and acquire, by way of subscription, purchase or otherwise the securities of any other body corporate, exceeding sixty per cent of its paid-up share capital and free reserves or hundred per cent of its free reserves, whichever is more.

However, a company may make loan, give any guarantee or provide security and/or make investment in aggregate exceeding the aforesaid limits of 60% or 100% if the same is previously authorized by a special resolution passed in a general meeting.

The Board of directors have been empowered to give guarantee without being previously authorized by a special resolution provided -

(a) a resolution is passed in the meeting of the Board authorizing to give guarantee in accordance with the provisions of Section 372A;

(b) there exists exceptional circumstances which prevent the company from obtaining previous authorization by a special resolution passed in a general meeting for giving a guarantee; and

(c) the resolution of the Board is confirmed within twelve months, in a general meeting of the company or the annual general meeting held immediately after passing of the Board resolution, whichever is earlier.

The resolution of the Board of Directors to make any loan or investment or to give any guarantee or security must be passed at a meeting of the Board with the consent of all the directors present at the meeting.

The company has to obtain prior approval of the public financial institution referred to in Section 4A, where any term loan is subsisting. However, the prior approval of Public Financial Institution shall not be required where the aggregate of loans and investments so far made, the amounts for which guarantee or security so far provided to or in all other bodies corporate, alongwith the investments, loans, security or guarantee proposed to be made or given does not exceed the limit of 60% of the paid up capital and free reserves and there is no default in repayment of loan instalments or payment of interest thereon as per the terms and conditions of such loan to the public financial institution.

Loan given to any body corporate must carry the rate of interest not lower than the prevailing bank rate being standard rate made public under Section 49 of the Reserve Bank of India Act, 1934.

A company, which has defaulted in complying with the provisions of Section 58A has been debarred from directly or indirectly making any loan to any body corporate; giving any guarantee, or provide security, in connection with a loan made by any other person to or to other person by, any body corporate; and acquiring, by way of subscription, purchase or otherwise the securities of any other body corporate, till such default is subsisting.

This prohibition operates in respect of any default under Section 58A and the Rules made thereunder and not only on the default of repayment of deposit or payment of interest thereon.

For diversifying funds as certain provisions are exempted for transactions between a holding and a subsidiary company, loans and advances are given to subsidiary companies down the chain without adequate security and sometimes with unsound financial position to the advantage of the latter and detriment of the former. Similarly, improper transfer of assets of one company to another is resorted to with the object of benefiting one and causing loss to the other. In the group companies a noticeable factor is that some of the companies have public participation while smaller group companies do not have public participation.

To avoid such pyramidal structures in the corporates, the companies Bill, 1997 has proposed that a company which is subsidiary of another company cannot become a holding company.

VII. EXEMPTIONS TO SECTION 372A

Section 372A provides exemptions in following circumstances:

(a) To any loan made, any guarantee given or any security provided or any investment made by –

  (i) a banking company, or an insurance company, or a housing finance company in the ordinary course of its business, or a company established with the object of financing industrial enterprises, or of providing infrastructural facilities;

  (ii) a company whose principal business is the acquisition of shares, stock, debentures or other securities;

  (iii) a private company, unless it is a subsidiary of a public company;

(b) To investment made in rights shares;

(c) To any loan made by a holding company to its wholly-owned subsidiary;

(d) To any guarantee given or any security provided by a holding company in respect of loan made to its wholly-owned subsidiary; or

(e) To acquisition by a holding company, by way of subscription, purchases or otherwise, the securities of its wholly-owned subsidiary.

Section 295 to override Section 372A

It should be noted that the provisions of Section 295 of the Companies Act will be applicable in case a loan is given by a company to another private company in which a director of the first company is a director or member of the private company. As a result, prior approval of the Central Government shall have to be taken for such a loan. Also in cases where one or more directors of the lending company exercise 25% or more of the total voting power in any other body corporate, approval of the Central Government would be necessary.

VIII. GROUPS COMPANIES - GLOBAL DEVELOPMENTS

Today the corporate reality is no longer the single independent public company, but the group of companies. The group of companies as a legitimate form of doing business has been recognized in the company law of various countries. Many countries regulate the groups by transparency requirements, while others apply the general corporate and civil law also to group situations and in some cases, States provide for special rules governing Group Companies.

Transparency of group relations

The 7th Company Law Directive of European communities on group accounts provides for consolidated financial statements in a group. In these group accounts the financial situation of the individual companies belonging to the group is not reflected. This may become a problem both for the shareholders and creditors of the parent as well as the subsidiary company. The shareholders and creditors of the parent may need additional information on the risks arising from the subsidiary for the parent since these risks may affect the parent. On the other hand, the annual report of the subsidiary may not adequately reflect the subsidiary's position as a dependent company in the group.

In a number of countries not only the parent company is listed, but also important subsidiaries. This may have sound economic reasons, but it is possible that the investing public is not aware of the fact that such a company is not independent, but belongs to a group with negative and/or positive implications.

More transparency of the group relations and possible risks arising from them both to the subsidiary and to the parent may therefore be required. This is even more acute after the Enron debacle and may be particularly urgent for banks and other financial institutions being members of a group and as such having a special role in reorganisations. Relevant information may relate to the group structure, the managing system and the persons effectively entrusted with the power of direction, the existing intra-group transactions, the procedures and the activities through which the direction is exercised.

Creation and Functioning of Groups of Companies

In many countries of the European Communities the creation and functioning of groups of companies is complicated by the fact that the management of the subsidiary may not take into consideration the economic interest of the group as a whole unless this is in the own particular interest of the subsidiary. Violations may make the directors liable both under criminal and private law. The result seems to be a clear impediment to the formation and functioning of groups of companies.

The economic advantages of forming a group are such as to overcome costs and risks arising from the non-recognition of group management. The economic reality is usually some sort of an uneasy compromise. Often the directors of subsidiaries do take into consideration the interest of the group either by following instructions of the parent or without such instructions by subservience or by following economic rationality. If they do not, they face difficulties imposed by the parent or caused within the group. In more extreme cases, they are dismissed, whether the disregard of the interest of the group is legally prescribed or naot. Sometimes the parent avoids these difficulties by forming a 100 %-subsidiary and avoids the subsidiary going bankrupt.

This leads to considerable costs and legal uncertainty regarding the limits of what directors of a subsidiary are still allowed to do, i.e. whether an action that is in the interest of the group but may be harmful to the subsidiary in the short run, could be justified for being in the long-term interest of the subsidiary. If the interest of the group is pursued and even if a risky compromise between the subsidiary's and the group's interest is found, this is at a considerable risk for the directors of the subsidiary and, in case of instructions or under the concept of aiding and abetting, also for the directors of the parent. While in many cases the conflict may not appear at the surface, it is becoming a real problem in cases of insolvency or if directors' liability towards individual shareholders is recognised. This risk is particularly difficult to evaluate in case of cross-border groups of companies.

The German "Konzernrecht" shows one way of dealing with the problem. The parent and the subsidiary may conclude an enterprise contract and form a so-called contractual group. The law of groups allows steering a group independently of the interests of the subsidiaries, but only at the price of specific protection of the shareholders and creditors of the subsidiary by regular compensation of disadvantages incurred by the subsidiary.

The France and some other Members of European Union, have shown a less burdensome and complicated way to solve the problem. The so-called "Rozenblum" concept has been developed by French penal courts in order to mitigate the severity of the criminal law on the breach of trust. It strikes a reasonable balance between the interest of the individual companies within a group and the overall interest of the group. Under certain conditions it is considered to be legitimate for the directors of subsidiaries as well as for those of the parent and of other members of the group to act in the overall interest of the group as such. The conditions for such a safe harbour under French law are - firm structural establishment of the group; coherent group policy; and balanced distribution of benefits and burdens.

The approach represented by the law of the UK is that since companies formed under the law are to be run in the interests, ultimately, of their shareholders as a whole, it follows that wholly owned subsidiaries are to be run in the interest of the parent company. This means that the directors, subject to their duties towards creditors are bound to ensure that the subsidiary is operated to serve the parent company's objectives. Where a subsidiary is only partly owned by the parent, the directors must however still ensure that they run the company fairly for the benefit of the shareholders as a whole, taking full account of all the circumstances, including the balance of advantage which comes *inter alia* from membership in the group. If a fair balance is not maintained in their favour, the minority, or outside shareholders have remedies for breach of this duty, by derivative action to enforce the fiduciary duty to act fairly on their behalf, or through the general "oppression" remedy.

The Modern Company Law Review undertaken in the UK in recent years considered whether these rules required change in the group context and concluded that they provided the appropriate balance between freedom to operate the group enterprise and the protection of creditors and outside shareholders.

IX. TRANSFER PRICING

Transactions between group companies commonly occur in the normal course of business and there is no guarantee that all such transactions are secured in the best interest of the company or of the other stakeholders. Controlled entities, principal stockholders or management can execute transactions that improperly inflate or deflate earnings by masking their economic substance or distort reported results through improper disclosure, or can even defraud the company by transferring funds to conduit related parties and ultimately to the perpetrators. Recent business events reflect the increasing use of complex structures that include off-balance sheet entities.

Transfer Pricing - Meaning and Scope

Transfer price is the price charged by one unit/ segment to another unit/ segment of an organization in case of transactions between them. The term inter-unit transfer (intra-company transfer) is used to include any movement of products between divisions, plants or organizational units . The concept of transfer pricing is extended to inter company transfer when they are related in any way i.e. they are separately incorporated and are under the common control. The normal transaction between companies when they are not related in any way is termed as sale. But when they are related or under common control, these transactions are known as transfer in the accounting concept and the price so charged is termed as transfer price.

The term segment means unit, division, department, sales territory or branch. A segment is formed by grouping of activities on the basis of the functions, products, customers or geographical territories. Traditionally, inter segment transaction includes transfer of products and services within an entity. The transfer pricing policy has gained importance in the transaction of a business enterprise because of its requirement of reporting of financial information by segment and related party transactions as focused in the International Accounting Standard (IAS 14 & IAS 24) and Accounting Standard (AS 17 & AS 18). The Accounting Standards require inter alia disclosure of segment wise sales, other operating revenues, profit etc and basis for inter segment pricing. Thus, all the disclosures to be made under the above standards are to assist the transfer pricing analysis. In the era of open competition and liberalization, the focus has been on performance and revenue earning capabilities of individual segment and adoption of a rational basis of transfer pricing.

The term "related party" means a party that directly or indirectly through one or more intermediaries controls or is controlled by or is under common control with an enterprise. In other words, under three circumstances the company A is considered as an affiliate of another company B if

- A either directly or through intermediaries controls B
- B either directly or through intermediaries controls A
- Both A & B are under the control of another company C

The term 'control' is defined in IAS 24 "Related Party Disclosure " as —

- Either enjoyment of more than one half of the voting power or substantial voting power directly or through subsidiaries indirectly.
- Power to direct the operating and financial policies of the management by statute or agreement

Transfer pricing under related party relationships is a normal feature of commerce and business. Many enterprises frequently carry on their activities through subsidiary or associated enterprises and acquire interest in other enterprises in investment or trading. The parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operating decisions. Related party transactions has special relevance in the era of globalization and due to increasing concentration of international economic activities in the hands of multi-national enterprises.

Possible Modes Of Abuse Of Transfer Pricing

Some of the related party transactions, which are usually resorted to for diversion of funds are detailed below. Transfer Pricing Guidelines, if any, shall help in curbing these transactions.

(a) Purchase of goods or services from a related party at little or no cost or at inflated prices to the entity.

(b) Payments for services never rendered at inflated prices.

(c) Sales at below market rates to an unnecessary "middle man" related party, who in turn sells to the ultimate customer at a higher price with the related party (ultimately its principals) retaining the difference.

(d) Purchase of assets at prices in excess of fair market value.

(e) Use of trade names or patent rights at exorbitant rates even after their expiry or at a price much higher than the price, which cannot be described as reasonable.

(f) Borrowing or lending on an interest-free basis or at a rate of interest significantly above or below market rates prevailing at the time of the transaction.

(g) Exchanging property for similar property in a non-monetary transaction.

(h) Selling real estate at a price that differs significantly from its appraised value.

(i) Accruing interest at above market rates on loans.

Objective of Transfer Pricing Guidelines

(a) To enable the pricing of related party transactions both in national or international trade to have a definite, uniform and consistent policy.

(b) To enable the correct assessment of assets, investments and profitability of the units or affiliates of an organization.

(c) To restrict the scope of manipulation in transfer pricing to ensure fair picture of performance of each individual entity in a group organization towards better strategic decision making

(d) To establish better understanding and confidence between the industry and the financial institution by checking the manipulation in periodic statements of the company

(e) To protect the interest of Indian industry to ensure fair competition and stable growth

(f) To check the evasion of taxes, duties and tariffs to promote revenue generation in Government exchequer.

(g) To protect consumers from undue higher price of product

Transfer Pricing and Corporate Governance

Establishment of fair transfer pricing policy in relation to related party transactions will reduce the scope of manipulation in the financial results and will play a big role in projecting true and fair picture of affairs of business activities in different units in an organization. This will promote the cause of corporate governance to a great extent in the following way :

(a) Better transparency in the business activities by disclosure of true and fair picture of each separate entity in the organization for correct reporting to the shareholders.

(b) To ensure better strategic decision based on performance of individual units towards optimum profitability.

(c) To protect the interest of the investors from illegal transfer of fund and manipulation of financial results.

(d) To bring confidence of the shareholders and investors by displaying the correct status of each individual units of the company in terms of assets and profitability.

(e) To Check the manipulation in presentation of financial performance of subsidiary corporate entity under the control of a bigger holding company.

Transfer Pricing - Income Tax Aspect

Transfer pricing concept has also relevance under the various provisions of the Income-tax Act. The increasing participation of multinational groups in economic activities in the country has given rise to new and complex issues emerging from transactions entered into between two or more enterprises belonging to the same multinational group. Existing section 92 did not explain the methodology to be followed in determining of ordinary profit. To overcome the problem and to broaden the existing statutory framework existing section 92 has been substituted and further new sections 92A to 92F have been inserted in the Income-Tax Act, by the Finance Act, 2001. These provisions relate to computation of income from international transactions having regard to arm's length price, meaning of associated enterprise, meaning of international transaction, determining of arm's length price, keeping and maintaining of information and documents, furnishing a report from an accountant etc.

Existing and New Provisions

Section 40A(2) and Section 92 of the Income-tax Act, 1961 deal with transaction with related parties. Section 40A(2) covers transactions with all parties residents as well as non residents. It defines the term persons "person having substantial interest" as to one who basically holds 20% or more share holding. Its emphasis is on fair market value of goods or services purchased by the assessee for the legitimate needs of the business or profession of the assessee. This section authorizes the assessing officer to disallow any business expenses representing payment made to the connected persons which are **excessive** and **unreasonable** having regard to the fair market value of the goods, services or facilities. In the absence of market value or commercial character for the goods, services or facilities the provisions of section 40A (2) cannot be attracted [TT (P) Limited Vs. ITO [121 ITR 551 (KAR)]. The emphasis of this section is about disallowing any excessive or unreasonable expenses. If no expenditure has been incurred but discount has been allowed to related party in respect of goods sold the discount allowed cannot be considered as "expenditure" and provision of section 40A (2) will not be attracted. The connected parties are identified in clause (b) of sub-section (2) of section 40A (2). Fair market value mentioned in this should imply comparable market price.

Other various existing provisions which have relevance in regard to transfer pricing concept are as under:

Section 92 - Definition of Arm's Length Price

Section 92 (as substituted) is quite elaborate and provides that any income arising from an international transaction shall be commuted having regard to the arm's length price. Arm's length price is defined to mean a price which is applied or proposed to be applied in a transaction between persons other than associated enterprises in uncontrolled conditions. It further provides that the cost or expenses incurred or to be incurred, or allocated, or apportioned to, or as the case may be, shall be at arm's length price between two or more associated enterprises. Rule 10A also defines the following terms used in the computation of arm's length price :

(a) Uncontrolled transactions means a transaction between enterprises other than associated enterprises whether resident or non-resident;

(b) Property includes goods, articles or things and intangible property;

(c) Services include financial services;

(d) Transaction include a number of closely linked transactions.

Section 92A – Definition of Associated Enterprise

Section 92A(1) defines associated enterprise as an enterprise :

— Which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of other enterprise; or

— In respect of one or more persons who participate, directly or indirectly, through one or more intermediaries, in the management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of other enterprise.

The term 'participation in management' has been defined as to mean taking part in decision making in the business affairs and term 'control' has been defined as to mean the power of directing, restraining and holding in check.

Section 92B – Definition of International Transaction

For the purpose of this section and the sections 92C, 92D and 92E, the international transaction means a transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of purchase, sale, or lease of tangible or intangible property, or provision of services, or lending or borrowing money or any other transaction having a bearing on the profits, income, losses or assets of such enterprises and shall include a mutual agreement between two associated enterprises for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service, facility provided or to be provided to any one or more such enterprises.

Thus, the definition of international transaction under section 92B has been made very wide. It includes almost all types of transactions a resident can undertake. It also includes:

(a) Transaction between two non-residents

(b) Transactions relating to purchase, sale, lease of tangible property / intangible property

(c) Provision of services

(d) Lending or borrowing of money

(e) Any arrangement or agreement on sharing cost

(f) Any transaction having bearing on the profits, losses or assets of an associated enterprise

Here, the term "agreement" has been defined as to mean a contract i.e. a legally binding arrangement between two or more persons, by which right are acquired by one or more acts of forbearance on the part of the other or others.

Deemed International Transaction

Section 92B(2) provides that a transaction entered into by an enterprise with a person other than the associated enterprise, will be deemed as transaction with an associated if any of the following conditions are satisfied :

— There exists a prior arrangement in relation to the relevant transaction between such other person and the associated entries;

— The terms of the relevant transaction are determined in substance between such other person and the associated enterprise.

Determination of Arm's Length Price

According to section 92C, the arm's length price in relation to international transaction shall be determined by any of the following methods (being the most appropriate method having regard to the nature of transaction or clause of transaction / clause of associated persons or functions performance:

1. Comparable Uncontrolled Price Method (CUP)
2. Resale Price Method (RPM)
3. Cost Plus Method
4. Profit Split Method
5. Transactional Net Margin Method (TNM)

Section 92C (2) provides that where more than one price may be determined by the most appropriate method, the arm's length price shall be taken to be the arithmetical means of such prices.

Other Issues

Transfer price system can range from the very simple to the extremely complex depending on the nature of the business. When viewed strictly from a business perspective, another factor greatly influencing pricing decision is the market environment. It is also effected by the following two classes of considerations:

(a) Multinational Enterprise viewpoint

— Environmental issues

— Behavioral context

— Responsibility accounting

(b) Tax administrator' view point.

Section 92D - Records to be maintained - General Information on the business

The following records are to be maintained in relation to inter-company transfer :

(a) records relating to ownership structure of the company with details of shares or other ownership interest held by other enterprise;

(b) names and addresses of all associated enterprises within the meaning of sub-section (2) of section 92A of Income Tax Act with details of the relationship with each such enterprise;

(c) the nature and terms (including prices) of transactions entered into with each associated enterprise, and the quantum and the value of each such transaction;

(d) an overview of the business of the company and a description of the business of the associated enterprises with whom the company has transacted;

(e) all commercial agreements setting forth the terms and conditions of transactions with associated enterprises as well as with third parties;

(f) record of any forecasts, budgets or any other financial estimates prepared by the company for the business as a whole and for each division or product separately;

(g) detail of the property or services to which the transactions relate;

(h) description of the functions performed, risks assumed and assets utilized by the company and by the associated enterprises involved in the international transaction.

XI. CONSOLIDATION OF ACCOUNTS

While most market participants agree that with globalization gathering momentum, the need for such a move is greater. The demands from various quarters include tax breaks, lead time and clarity in accounting standards.

Group accounts, or consolidated accounts, depicts the balance sheet and financial performance of a holding (parent) company and its subsidiaries as if they were a single company. Consolidation of accounts, inter alia, is a move towards better reporting standards and a step towards better disclosures for judging corporate governance. Consolidation improves the borrowing power of a company and is very useful since a group's actual position and performance is reflected by eliminating intra group transactions.

Benefits of consolidation

(a) This will present a complete picture of the size of the group, its related activities and overall financial health of the holding company.

(b) This will eliminate inter – company transactions.

(c) This will help in identifying significant dealings with subsidiary companies

(d) Reasonably accurate intrinsic share value of the holding company can be calculated directly from the consolidated Balance Sheet.

(e) Consolidated financial statements provide information for identifying the right overall profits for determining return on investment.

(f) The minority interest data of the consolidated financial statement indicates the amount payable to the minority share holders of the subsidiary company at book value which is used as starting point of negotiation at the time of acquisition of a subsidiary and holding company.

Recommendations of the Birla Committee

In respect of consolidation of Accounts of subsidiaries, the committee recommended that the companies should be required to give consolidated accounts in respect of all its subsidiaries in which they hold 51% or more of the share capital.

ACCOUNTING STANDARD - 21

Accounting Standard (AS) 21, Consolidated Financial statements, came into effect in respect of accounting periods commencing on or after 1-4-2001. AS 21 is mandatory if an enterprise presents consolidated financial statements. In other words, the accounting standard does not mandate an enterprise to present consolidated financial statements but, if the enterprise present consolidated financial statements for complying with the requirements of any statute or otherwise, it should prepare and present consolidated financial statements in accordance with AS 21.

Control, for the purpose of this accounting standard, is defined as a situation where parent owns, directly or indirectly through subsidiaries more than one half of the voting powers of an enterprise or where it controls the composition of the board of directors so as to obtain economic benefit from its activities.

The standard would not apply to accounting for investments in associates, JVs and amalgamations. The consolidated financial statement, which includes consolidated balances sheet, profit and loss account and notes, would have to be presented in the same format as that adopted by the parent company for its separate statement. Further the parent company would be required to consolidate statement of foreign subsidiaries in the statement.

Subsidiaries which are under temporary control of an enterprise or which operate under severe long term restrictions which impair their ability to transfer funds to parent are to be excluded. Intra group balances and intra group transactions and resulting unrealized profits would need to be eliminated in full. Unrealised losses resulting from intro group transactions would also be need to be eliminated unless the cost cannot be recovered.

The standard further prescribes that financial statements used in consolidation should be drawn up to the same reporting date. If that is not practicable and financial statements of subsidiaries drawn up to different dates are considered, the standard requires adjustments to be made for the effect of any significant transactions or events that may have occurred.

Issues for Deliberations

Inter-related companies have become the order of the day. In many cases, this facility has been abused to perpetuate control by the promoter group, with meagre investment in the group as a whole. In the backdrop of liberalisation and extensive corporate restructuring across the globe, it becomes imperative that the structure of big corporate houses is relooked to ensure that abuses are minimised. The emerging issues in this context include various aspects of Group Companies, such as structure, legal framework, impact on economic growth. These issues may be clarified and summarised in the following manner—

(i) Whether the device of group companies facilitates the economic growth of the country ?

(ii) What should be the policy goal of law – should it facilitate and encourage group companies or should they be put under a strict vigil ?

(iii) What are the possible modes of abuse and perpetration of power through group companies ?

(iv) Is the legal framework effective enough to detect the potential abuses ?

(v) How to ensure the minimum standard of duties of the directors and controlling shareholder of the parent company towards its subsidiaries.

(vi) What are the abuses associated with the preferential allotment of shares to the promoter groups ?

(vii) How to prevent the misuse of the concept of "separate legal entity" for limiting liability in a group structure ?

(viii) How to prevent misuse of the funds of the subsidiary by the parent company ?

(ix) How to prevent the misuse of related entitites such as trusts, charities and SPVs to avoid liability ?

(x) How to address window dressing of balance sheets of group companies showing losses and risky ventures of parents as those of subsidiaries ?

(xi) How to prevent the abuse of inter-group transactions through transfer pricing ?

(xii) How to address the abuses of transfer pricing for the purposes of tax evasion ?

(xiii) Should Consolidated Accounting Practices for group companies be mandatory ?

(xiv) Whether stricter accounting practices for group companies necessary/desirable ?

(xv) How to prevent circumvention of the competition law regime relating to the abuse of dominance, specifically in the context of the market share of the subsidiaries not being shown as the market share of the parent ?

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HARMONISATION OF COMPANY LAW — EMERGING TRENDS AND ROAD AHEAD

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I. INTRODUCTION

Today, the modern economy is witnessing a dominant role being played by companies as an important vehicle to accelerate the process of development. Companies are not only the principal buyers and sellers of goods but major borrowers and consumers of services and the important conveyors of new technologies across the world. Volumes of business transacted by business corporations have grown tremendously and their presence in the society has become significant. It is appropriate to describe large business corporations doing business on a global scale as a new and important institution which humanity created in the twentieth century. However, large publicly held business corporations are more typical in representing the dominant qualities of the present age. One can notice in them the key characteristics of the present age which include the elevation of profit to a moral principle, singular devotion to profit maximization, high degree of consumerism, emphasis on effectiveness rather than integrity, and competition and competitiveness rather than coexistence and cooperation.

The corporate landscape in India which now comprises of over 5.8 lakh companies with estimated paid-up capital of about Rs. 3,39,801 crores has witnessed multifaceted growth and expansion. The corporate sector being prime indicator of the health of the national economy has also contributed significantly to the economic growth of the country and well being of the society. However, this growth and expansion is punctuated by the increasing incidences of fly by night companies, market manipulations, insider trading, mismanagement, widespread shareholders' dissatisfaction and unethical business practices and recurrence of several scams, considerably eroding the investors' confidence.

These incidences led to the prominence of good corporate governance within the corporate sector, financial institutions, enlightened business associations, regulating agencies and the Government. This sets the imperatives for reforms in Company Law.

II. HARMONISATION OF COMPANY LAW – EMERGING TRENDS

(A) International Developments

(i) *White Paper on Modernising Company Law*

In U.K. a White Paper containing Government's proposals for modernising and reforming Company Law has been released by the Secretary of State for Trade and Industries in July, 2002. This White Paper aims at providing a legal framework for all companies reflecting the needs of the modern economy and to ensure that the framework is kept upto date in future. Major proposals contained in the White Paper include removing the requirement for private companies to hold Annual General Meetings (AGMs) unless members want them; and simplifying the rules on written resolutions to make it easier for private companies to take decisions.

With a view to increase transparency, the White Paper proposes that company constitutions be a simple document. Provision for simpler, clearer models for both private and public companies; AGMs to be held within six months of the financial year

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end for public companies and ten months for private companies; shareholders to be able to require a scrutiny of a poll, and proxies to have extended rights.

The White Paper also emphasises that the primary role of directors should be to promote the success of the company for the benefit of its shareholders as a whole and that directors' general duties to the company should be codified. The White Paper also proposes to prepare clear guidance for new directors. Besides, the white paper suggests that the company reporting should provide accurate, accessible information at reasonable cost. In this context, the White Paper proposes to replace the current directors' report; simplify the accounts of small companies; abolish the option for small and medium sized companies to file abbreviated accounts at Companies House; and to reduce the time allowed to file accounts to seven months for private companies, and six months for public companies. The very large companies are proposed to provide an Operating and Financial Review, i.e. a narrative report on company's business, its performance and future plans. It also proposes to require quoted companies to prepare a directors' remuneration report.

Other proposals contained in the White Paper include simplifying and updating the law on company formation and capital maintenance, particularly for private companies and simplification of law regulating companies incorporated overseas and operating in Great Britain.

(ii) *International Survey of Companies Law in Commonwealth, North America, Asia and Europe*

An International Survey of Companies Law in the Commonwealth, North America, Asia and Europe identified that the prime movers for the high level of legislative activities in company law in UK has been the imposition of European Commission directives which have their source in the civil law tradition. With the arrival of the European Monetary Union, however, there are indications that impediments to greater harmonisation and, importantly, the implementation of a pan-European Company Law, will finally be overcome. There are also indications that the United Kingdom will assert, quite justifiably, given its rich commercial law heritage, a greater leadership role in the future development of European Company Law.

Survey also identified that for some time now the U K Companies legislation has not served as a model to other jurisdictions as it had in the colonial past. Commonwealth and other jurisdictions which have traditionally relied heavily on the U K as the source of their company law have broken new paths or found themselves at an impasse. Canada made the break over twenty years ago using the U.S Model Business Corporations Act as its starting point. New Zealand, in implementing the Companies Act, 1993, has turned to North American models, much as Canada did before it. Australia, for many reasons, began a major company law reform initiative in 1993, which has been proceeding rapidly apace. In terms of the future direction of Australian corporate law, the jurisdictions considered to be of most direct relevance now are, first, Canada and second, the United States. Jurisdictions as different as Singapore, South Africa and the Peoples Republic of China have also turned to solutions and approaches developed in other jurisdictions.

South Africa, as a mixed civil law/common law jurisdiction, is an interesting case in point, the survey pointed out. The North American influences on the South African Close Corporations Act of 1984 are quite obvious; the European civil law influences may be subtler. While looking to Malaysia and Australia as its traditional sources of Company Law, Singapore was in fact indirectly modeling its legislation on that of the U.K. Over the time however, Singapore did not hesitate to look elsewhere for solutions to problem areas and in doing so, adapting them to local circumstances. The result has been a rather eclectic and fairly indigenous mix, but with more pronounced North American overtones of late.

Singapore and Peoples Republic of China have shown fairly eclectic taste in fashioning their company law. Bermuda's very specialized forms of incorporation have been highly tailored to suit local circumstances and foster the local economy. Despite a Memorandum of Understanding between Australia and New Zealand concerning harmonisation of commercial law, New Zealand did not feel overly compelled to coordinate its new approach to companies law with that in Australia.

The survey clearly indicates that the worldwide reforms process in companies law does not subscribe to any particular legal system, rather there is a growing tendency towards accommodating local needs and policy compulsions of individual countries. Thus, an overview of developments in companies law the world over presents a mix of worldwide developments, national policy imperatives and local business demands.

(B) Developments in India

The Company Law in India has been undergoing a phase of transition over the last 25 years. More than a dozen major legislative initiatives have been introduced or attempted in Indian Company Law. As mentioned earlier, the prime mover for this high level of company law reforms process has been the changing corporate landscape and internationalisation of business. However, with the initiation of market oriented policies in July 1991, the Government has expedited the process to modify the company law in line with policy objectives and to harmonise it with the international developments.

In the year 1996, a Working Group was constituted to re-write the Companies Act, to facilitate healthy growth of Indian corporate sector under a liberalised, fast changing and highly competitive and contestable business environment. Based on the Report prepared by the Working Group and taking into account the developments that had taken place in corporate structure, administration and the regulatory framework the world over, the Companies Bill, 1997 was introduced in Rajya Sabha on August 14, 1997 to replace the Companies Act, 1956. Since the Bill of 1977 was under consideration and an urgent need was felt to amend the Companies Act, the President of India promulgated the Companies (Amendment) Ordinance, 1998 which was later replaced by the Companies (Amendment) Act, 1999 to surge the capital market by boosting morale of national business houses besides encouraging FIIs as well as FDI in the country. The amendment of 1999 brought about number of important changes to tailor the Companies Act in consonance with the then prevailing economic environment and to further Government policy of deregulation and globalisation of economy.

The corporate sector was given the facility to buy-back company's own shares, provisions relating to investments and loans were rationalised and liberalised besides the requirement of approval of the Central Government on investment decisions was dispensed with, and companies were allowed to issue "sweat equity" in lieu of intellectual property. With a view to ensure standardization of accounting practices of financial reporting, the compliance of Indian Accounting Standards was made mandatory. Accordingly, National Committee on Accounting Standards was set up. Investor Education and Protection Fund has been set up to educate the investors to enable them to take well informed and considered investment decisions.

With a view to expedite the harmonization process, the Companies Act was further amended in the year 2000 to provide certain measures of good corporate governance and for ensuring meaningful shareholders' democracy in the working of companies. The amendments effected in the year 2000, include inter alia setting up of Audit Committee, introduction of Postal Ballot and Shelf Prospectus, abolition of the office of the Public Trustee, abolition of the concept of "Deemed Companies", appointment of auditors in the Government companies directly by the Comptroller and Auditor General of India, restricting a person to become director in not more than 15 companies, prohibiting an auditor to hold securities carrying voting rights, introduction of secretarial compliance certificate to ensure better compliance of Companies Act by smaller companies, deletion of redundant provisions relating to managing agents, secretaries and treasurers and increase in penalties by way of fine to ten fold.

PROPOSED CHANGES IN THE COMPANIES ACT

With a view to initiate further reforms, the Government has introduced the Companies (Amendment) Bill, 2001 and the Companies (Second Amendment) Bill, 2001. With their passage, the profile of company law will undergo further changes to bring it in tune with the best practices in corporate governance as are available globally.

Proposed Insolvency Law

The Companies (Amendment) Bill, 2001 was introduced in the Lok Sabha on 30th August, 2001. The Bill has been introduced with the main objective of facilitating or expediting revival/rehabilitation of sick companies and protection of workers interest and whenever necessary winding up of companies. The proposals in the Bill have taken into consideration the latest developments and innovations in Corporate Laws and has given due weightage to the international practices as well as the recommendations of Justice V. Balakrishna Eradi Committee.

The Companies (Amendment) Bill, 2001, provides for a new insolvency law designed to wind up and liquidate companies within a time frame of two years as against the existing cumbersome procedure taking between 18 to 26 years time. The exit policy envisaged under this Bill provides for initiation of restructuring of a corporate at the onset of financial sickness rather than the present approach of revival of a sick company. At the same time, it provides for a safety net for the workers and investors through better terms by setting up a Rehabilitation Fund and other allied measures.

Constitution of National Company Law Tribunal

The Companies (Amendment) Bill, 2001 provides for constitution of a National Company Law Tribunal. The jurisdiction and powers presently conferred on Company Law Board will be vested in the proposed National Company Law Tribunal and will result in the dissolution of the Company Law Board. The jurisdiction and powers relating to amalgamation, winding up etc. presently vested in High Courts are being brought under the purview of the National Company Law Tribunal.

Multiplicity of litigation before various courts/ quasi judicial bodies/forums will also be avoided and put to an end. All such matters will be heard and decided by the proposed National Company Law Tribunal, which would have sufficient number of benches across the country. The National Company Law Tribunal will have contempt of Court powers and hence there will be an in built seriousness. All the litigants will be bound by the decisions of the National Company Law Tribunal and in case of non-availability of workable proposal for revival/ rehabilitation etc. the National Tribunal may decide the matter on merits. Efforts of the National Company Law Tribunal will be to revive/rehabilitate the companies and as a last resort to order winding up.

Formation and conversion of co-operatives into producer companies

With globalisation and growing competition and emerging new opportunities there is a compelling need that institutions are linked to rural economy and keeping this in view, the Government constituted a Committee consisting of experts led by Dr. Y K Alagh, Economist and former Union Minister to examine and make recommendations with regard to (a) framing a legislation to enable incorporation of cooperatives as companies and conversion of existing cooperatives into companies, and (b) ensuring that the proposed legislation accommodates the unique elements of cooperative business within a regulatory framework similar to that of companies.

Based on the recommendations of this Committee, the Companies (Second Amendment) Bill, 2001 was introduced in Parliament providing for conversion of co-operative businesses into producer companies, under a regulatory framework similar to that of private limited companies.

The object of this Bill is to enable these companies to access the capital markets and banking system for their growth. The producer company may also revert itself into an inter state coopratrive society. Disputes relating to formation, management or business etc. of Producer Company are proposed to be settled by conciliator or by arbitrator as provided under the Arbitration and Conciliation Act, 1996. Under the proposed law, a member's equity may not be publicly traded, but may only be transferred with the approval of the producer company's Board of Directors to another person who fully meets the conditions for membership. An in-built mechanism has been put in place in the proposed Law so that producer companies are not vulnerable to takeover by multinationals or other companies.

Liquidators from panel of professionals

With the view to professionalise the role of official liquidator, the Companies (Amendment) Bill, 2001 proposes that the official liquidator may be appointed from a panel of professional firms of Chartered

Accountants, Company Secretaries, Cost & Works Accountants, Advocates or firms having condominium of these professionals.

The panel has to be constituted by the Central Government from which the Tribunal would select professionals to be appointed as the official liquidator. In addition, the official liquidator could also be a body corporate, consisting of such professionals as may be approved by the Central Government. The Tribunal is authorised to regulate the terms and conditions of appointment of the official liquidator. The limit of the remuneration of the official liquidator as proposed in the Bill is 5% of the value of debt recovered and realisation of sale of assets. The Bill further vests the Tribunal with powers for proper administration such as power to transfer the case from one liquidator to another, power for removal of official liquidator and power to proceed against the official liquidator for any professional misconduct.

Notwithstanding the path that has been treaded in the context of harmonization of the Companies Act since its inception in 1956, there are several other areas which need consideration of the Government. In order to ensure smooth and efficient functioning of companies. It is imperative on the part of the Government to further expedite the process of harmonization of company law in India to give further boost to our companies so that they can fine tune their working in line with international business practices and compete globally with multinational companies

III. HARMONISATION OF COMPANY LAW – THE ROAD AHEAD

(A) Tailoring the Company Law Conforming to Changing International Business Environment

Synchronization of Companies Act with Information Technology Act, 2000

In view of ever increasing importance of information technology, the synchronization of Companies Act with Information Technology Act is necessary to give it a more contemporary shape and to make it corporate friendly. It is understood that the Companies Act, 1956 is in the process of being synergized with the Information Technology Act, 2000. This will ultimately enable electronic filing of returns by companies in the offices of Registrars of Companies. Various areas of corporate governance falling within the domain of Companies Act, 1956 and other related laws and rules made thereunder are being harmonized with the Information Technology Act, 2000. Once information relating to corporates is available on line, it would be a step forward for corporate democracy as the shareholders can easily access all relevant information while exercising their right to vote. Investors can file their complaints on line and also monitor the progress thereof through official website of Department of Company Affairs.

Need for Allowing Board Meetings through Video Conferencing

With the rapid and remarkable advancements in telecommunications, computer technology and electronics, it is possible today to hold and conduct company board meetings through video conferencing and similar electronic modes. In UK, USA and other developed countries, conduct of board meetings through video/ telephone conference has been accorded legal recognition. In India, the Information Technology Act, 2000 has also provided legal recognition to transactions carried on in electronic data exchange and other modes of electronic communication. However, the Companies Act, 1956 does not provide for holding of Board meetings through telephone, electronic or other communication facilities. In this context, the process has been initiated by the Government to allow holding of board meetings through video/teleconferencing under the Companies Act.

Need to strengthen the procedure for Incorporation of Companies

In view of growing incidences of vanishing companies modification required under the Companies Act is to make provision for verification of persons forming the companies. Empirical evidence corroborates that certain companies disappeared and their subscribers eloped soon after collecting funds from the public through public issue of shares, debentures, bonds or mobilisation of deposits etc. In the absence of adequate data of persons at the helm of such companies, enormous problems are being faced in locating and initiating legal action against such vanishing companies and their alleged delinquent subscribers/directors/promoters. Section 15 of the Act requires that the

Memorandum of Association of a company shall be signed by each subscriber who shall add his address, description and occupation, if any. As such, when a new company is formed the subscription clause of its memorandum is required to contain the details of its subscribers such as their addresses, description and occupations etc. These details are merely required to be attested by a witness. There is, however, at present no procedure of verification of the declarations made and the Registrar accepts these details in the form as presented in the Memorandum by persons (subscribers) desirous of forming the company.

In this context, the R D Joshi Committee has suggested that a subscriber to the memorandum besides providing a photograph should be required to furnish details of his/her Permanent Account Number (PAN), Identity Card issued by Election Commission of India etc. along with his/her address/description, occupation and proof of his/her identity. This would help to trace out the unscrupulous persons who disappear, elope or impersonate after cheating the public through the mode of companies formed by them for such deceitful purposes.

Need to Enlarge the Scope of Explanatory Statement to Notice

In the present setting under section 173 the Explanatory Statement annexed to the notice of a meeting in respect of a special business takes care of information about director's interest, it does not however, cover cases where a director's relative is involved or he has a pecuniary interest in the transaction. It is, therefore, desirable that the present provision about disclosure should be further strengthened by requiring a company to disclose the financial implications and specific nature of the interest of any director/manager and/or his relative, if any, in such a manner so as to enable a shareholder to take a view on a proposed issue in a meaningful manner. The company should also be required to give 'particulars of the shareholding interest of the director's relative in that other company'. R D Joshi Committee has suggested that a liability be cast on director or manager for non-disclosure or insufficient disclosure, to hold in trust, the benefits received by him, directly or indirectly and reimburse or compensate the company. Similarly, penal provisions for default should also be strengthened.

(B) Focused Approach towards Good Corporate Governance

Distribution of Gifts at Annual General Meetings

An unethical practice that has been in vogue for sometime now is the distribution of gifts at AGMs of the companies. Such practices require immediate government intervention. The practice adopted by some unscrupulous promoters has spread as a disease compelling others to follow the same path. At times, this creates problems as certain unscrupulous shareholders pressurize the Board of directors at the general meetings to distribute gifts either in cash or kind to the shareholders present at the meeting. Moreover, such unscrupulous shareholders often succeed in creating unruly scene, disorder, and chaos at the general meetings. Since the Companies Act is silent on these issues absence of specific prohibition also gives leverage to unscrupulous promoters/directors to abuse this method and get their resolutions passed by alluring such shareholders present at the meeting with gifts. R D Joshi Committee has emphasised on the need to prohibit a company to give or for a shareholder to demand or accept any gift at any general meeting.

Need to Restrict the Number of Directors on the Board

The absence of a provision limiting the number of directors on the boards of the Companies, many a times has resulted in many companies having more than 15 directors compelling companies to bear the excess financial burden. The big boards slow down the decision making process. R D Joshi Committee has recommended that the maximum number of directors which a public limited company can appoint should be restricted to fifteen and in case of private limited company it should be not more than twelve.

Need to Fix the Retiring Age of Directors

A manager today has to work in a complex business environment. The activities of companies are becoming global and they have to be in strong positions to stand in the highly competitive global environment. The position of managing director, whole-time director, manager and directors of a company is, therefore, a strategic position, which requires innovative business ideas and their effective implementation. The persons holding such position, therefore, should be in perfect health with an alert mind. They should in no way be handicapped in meeting the challenges which the present day complex business environment is capable of generating every now and then. R D Joshi Committee has accordingly recommended that a ceiling on retirement age be provided in the Companies Act.

(C) Need for further Simplification of Procedures

The Government has taken a number of initiatives towards procedural simplification with a view to provide corporate sector a conducive environment to develop and grow in market economy. These measures have been taken to ensure that there is no unnecessary administrative intervention in the functioning of the companies in India. These measures include deletion of the requirement of obtaining confirmation of Company Law Board for amending the objects clause of the Memorandum of Association. Now, the companies can change their object clause by passing a special resolution. Companies have also been allowed to buy back their own securities and are not required to obtain the approval of Central Government for inter corporate loans/investments as per newly inserted Section 372A. Microfilms, facsimile copies of documents, computer printouts and documents and computer media are now recognised as documents and have been conferred evidentiary value. The companies are also allowed to issue "sweat equity" and issue shares to employees under ESOPs with a view to retain talent in the company. The requirement of stamping of transfer instruments has been dispensed with in the case of transfer of shares in depository system. The limits under Schedule XIII for payment of remuneration to managerial personnel by a company having losses or inadequate profits have been enhanced considerably and such companies have been permitted to pay increased remuneration without seeking approval of the Central Government.

Still there are number of provisions in the Companies Act which require approval of the Central Government, act as bottlenecks. It is, therefore desirable that the Government gives due consideration for providing hassle free corporate functioning.

Need to Expand the List of "Officer who is in Default"

Section 5 defines the term 'Officer who is in default' for the purpose of fixing the responsibility with regard to compliance of the provisions of the Act on certain categories of persons. In this context, R D Joshi Committee has suggested that the scope and ambit of 'Officer who is in default' be amplified so as to include independent directors, chief executive officer, chief operating officer and Chief Accounts Officer in respect of any contravention of the provisions of the Companies Act .

Need to Strengthen Financial Reporting – Consolidation of Accounts

Preparation of consolidated accounts within the group is an internationally established practice. This helps investors to get first hand information about the group as a whole for taking an informed decision for investment. This also helps Financial/Lending Institutions/ Banks to take decision for financing. In view of globalisation of the economy, it is very useful and advantageous for the companies to prepare their group accounts. R D Joshi Committee has accordingly proposed to make a provision in the Companies Act providing for preparation of consolidated accounts mandatorily by a holding company as and when notified by the Government. It has further proposed that a holding company need not attach alongwith its annual report the annual report of its subsidiary companies where such holding company prepares group accounts for itself and its subsidiaries.

Inspection of companies by professionals

The companies are required to comply with various provisions of the Companies Act, which in itself is a quite exhaustive piece of legislation running into more than 600 Sections and XV Schedules. Then there are large number of Rules and Regulations framed under the Act, which provide for various kinds of statutory disclosures and compliances. India has by now over half a million companies incorporated under the Companies Act. While some of them may be following and complying statutory provisions in letter and spirit sincerely but still a large section is not complying the law fully. The violations, non-compliances and disobediences of such companies can be found out only through vigorous inspections, which the Government is empowered to undertake under the provisions of the Companies Act. These inspections have, therefore, a very important role in identifying the defaulting companies and the infirmities/ violations noticed and thereafter taking action against them as per law.

The existing provisions as contained in Section 209A of the Companies Act provide that the books of account and other books and papers of every company shall be open to inspection by (i) Registrar, or (ii) by such officer of the Government as authorized by the Central Government in this behalf; (iii) by such officers of Securities and Exchange Board of India as may be authorized by it. It is well known that while there has been continuous growth in the number of companies, there has not been corresponding increase in the manpower available with the Department of Company Affairs of the Govt of India on which responsibility devolves to administer the provisions of the Companies Act. The number of companies whose books of account are inspected at present every year is on an average around 250, which is minuscule of total number of companies at work. Such number of inspections hardly makes any visible impact. The number of inspections, therefore, needs to be stepped up drastically for ensuring better compliance of the statutory provisions of the Companies Act. The need for inspection has also been heightened in view of more and more self-regulatory provisions having been incorporated in the Act in the recent past. The enormous increase in complexities of law, procedures and practices of corporate bodies have made imperative for an Inspector to have expertise and specialized knowledge in varied fields including law, accountancy, finance, trade, marketing etc. Moreover, inspecting manpower need to hone their skills continuously to reveal the violations. The existing blend of Inspection Officers needs to be complimented by professionals in practice. R D Joshi Committee has therefore, proposed that the Central Government be empowered inter-alia to notify professionals like Company Secretaries, Chartered Accountants, Cost Accountants or firms of such professionals whose services can be utilized for conducting inspection of books and records of companies under Section 209A of the Companies Act.

Chain of Subsidiaries

Section 4 of the Companies Act, describes the conditions under which a company shall be deemed to be a subsidiary of another company. Under this provision, it is possible to create a chain of subsidiaries, which can be used by corporates for siphoning of funds. Consequently, loans and advances can be given to subsidiary companies down the chain without adequate security, sometimes with unsound financial position and at low rates of interest to the advantage of the latter and detriment of the former. Similarly improper transfer of assets of one company to another is resorted to with the object of benefiting one to the prejudice of other. These subsidiaries are also used for the purpose of making cross investments and this is done in a chain system with the result it becomes very difficult to locate the end user of the fund. In the Group Companies, a noticeable factor is that some of the companies have public participation while smaller companies of Group do not have public participation. To avoid such pyramidal structures in the corporates, R D Joshi Committee has proposed that a company, which is subsidiary of another company, cannot become a holding company. This means only one level of subsidiary will be allowed. The only exception to this proposed amendment to be made is in case of subsidiaries of foreign companies set up in India. In this case, one more tier i.e. second level subsidiary has been recommended.

IV. CONCLUSION

Having enumerated the changes that have been witnessed in the character and scope of Company Law, worldwide as well as domestically, we only need to highlight two key sequels. One the codifiers need to ensure that the slated and desired changes in the legislative framework are engrossed at the earliest. Second, and not necessarily in order of importance, we need to ensure that the *litera leges* as well as *ratio leges* is enforced arduously so that good corporate governance does not remain a placebo but goes further to influence the way our corporate citizens abide.

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CORPORATE CITIZENSHIP— A KEY DETERMINANT FOR CORPORATE SUCCESS IN CHANGING INTERNATIONAL BUSINESS ENVIRONMENT

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I. INTRODUCTION

The business institution is society's principal mechanism for producing and distributing economic goods. The public policy circumscribes the activities of the business system and its rules govern the relationship among the members of the system and between business system and the society. Since public policy assign this realm to business, the purpose of business must be to deliver economic performance to society. Economic performance is both the means and the end of business system. It is the means, business uses to conduct its internal affairs, and it is the end, society seeks assigning a sphere to the business system.[1]

The early corporation was, of course, wholly a creature of the state. It was not perpetual in nature; it had a given life span; its powers were limited; and it could perform only those powers granted to it by the state legislature in its charter. As the use of the corporate device grew, state governments permitted the easier formation of corporations. Furthermore, the limitations on length of life and the powers of the corporation were gradually eased over time, with the result that a form of perpetual and fictitious legal entity was created and very broad corporate powers and activities emerged.

Paradigm Shift

The corporate sector in the last decade has witnessed a paradigm shift not only in terms of size, complexity and sophistication but in terms of growing expectations of shareholders, investors, customers and all other stakeholders.

Business, designing, making and selling goods and services, is not something separate from society. Business is and should be integral part of society. Any company, which is seriously mis-aligned with the hopes and fears of its fellow citizens, is likely to pay a price in lost reputation or sales for getting out of step. This has become all the more true with the globalisation of media. No company can afford double standards if it wants to escape the courage of published criticism for its hypocrisy.

We have moved from a "Trust Me" to a "Show Me" world. So there are negative drivers to keep companies on their toes, and push them towards a responsible approach to their activities. The term corporate citizenship implies the behaviour, which would maximize a company's positive impact and minimize the negative impact on its social and physical environment. It means moving from supply driven to more demand led strategies; keeping in mind the welfare of all stakeholders; more participatory approaches to working with communities; balancing the economic cost and benefits with the social; and finally dealing with processes rather than structures. The ultimate goal is to establish a dynamic relationship between the community, business and philanthropic activities so as to complement and supplement each other.

The issues which businesses find themselves most grappling with in the modern business environment – where the expectations of society are growing – include environmental impact – how to minimize it – human rights and how to protect them – infrastructure development – how to optimize the society contribution – education and training – how to develop work force and local skills – and community projects – how to be a good neighbour.

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What then should be the rules of engagement for companies anxious to do better on those and other issues? How should a company set about maximising the positive contribution it can make and minimizing negative impacts. In this regard following five simple percepts have been suggested :

— Make sure that the company understands the context and the communities around its operations. Treat the macro market with the same seriousness that the company treat the micro market for its goods and services.
— Aim for long-term sustainability. Short terms are the enemy of responsible engagement.
— Strive for transparency, openness and shared communication with those with whom you interact – stakeholders. Recognise that shared understanding creates trust.
— Create partnerships with shared objectives, where all parties contribute to the common well being. Gone are the days of paternalism. An effective contribution by business increasingly depends on the company finding the right partners, in NGOs and Central, State and local Government, and above all in the local community, and listening to them.
— Always try to build capacity locally.

II. CORPORATE CITIZENSHIP – GLOBAL PERSPECTIVE

The Friedman formulation that the business of business is business, has outlived its relevance. The social responsibility of business has become buzzword in international corporate arena and assumed importance for ensuring long term success of the companies.

As stakeholders demand more social responsibility and deeper dialogue, CSR reporting is bound to become as much part of company culture as the annual report.

In recent years, a number of organizations and initiatives have been attempting to standardize social and environmental reporting procedures to enable stakeholders to more easily assess companies' Corporate Social Responsibility. While there are many standards that cover one or more aspects of CSR, only a handful covers the full spectrum of issues.

At European level, the High Level Group on the economic and social consequences of industrial change set up following the Luxembourg Jobs Summit in November, 1997 suggested in its final report that "businesses having more than 1000 employees should publish a report on the management of change" each year, in order "to give an account of the impact of their social activities".

At the European Council Summit in Lisbon in March 2000, the Union set itself a new strategic goal for the next decade: to become the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion. Underlining the important contribution of the private sector in achieving this, the European Council for the first time addressed business directly in "a special appeal to companies' corporate sense of social responsibility regarding best practices on lifelong learning, work organization, equal opportunities, social inclusion and sustainable development".

In the Social Policy Agenda adopted in June, 2000, the Commission stressed the importance of Corporate Social Responsibility particularly in terms of the employment and social consequences of economic and market integration and the adaptation of working conditions to the new economy. Consequently, in 2001 the Commission has issued a communication to support initiatives related to corporate social responsibility and management of change.

The objective is to facilitate further development towards a framework for CSR practice at European level based on, and complementary to, already existing CSR initiatives in the business community and the Member States.

At the International level UNCTAD has argued the Role of Transnational Corporations for greater involvement and development. Fifty companies (including TISCO), business associations and civil society organsiations signed a Global Compact on July 26, 2000 to voluntarily embrace, support and enact a set of nine principles covering areas of labour standards, human rights and environment practices.

The UNDP in its Human Development Reports particularly of 1996 and 2000 has also tried to explore the role of business in development. World Bank has also initiated a project called Partners in Development, to find out ways to encourage tri-sector partnership between business, the State and civil society.

A look at the frameworks developed by leading corporations and business associations like The Prince of Wales Business Leaders' Forum (PWBLF), The London Benchmarking Group and other organisations working in the area like the Corporate Citizenship Company of the UK and the Asian Institute of Management, indicates a broad convergence in the description of what constitutes socially responsible behaviour by companies.

The Prince of Wales Business Leaders' Forum (PWBLF)

The PWBLF is one of the leading international organisations working on the issue of Corporate Social Responsibility. One of its book, Business as Partners in Development shows many ways in which a company can serve its stakeholders, namely through.

— The core business activities, which look at its policies, operations and production activities (in terms of safety, quality, environment implications, etc.), both within the business as well as its backward and forward linkages such as suppliers, distributors and customer relations.

— Social investments and philanthropy – i.e. moving from ad hoc giving to strategic approaches to building community partnerships, looking for 'win-win' solutions, applying core competencies to such investments and linking community investments to mainstream business strategy.

— Public policy dialogue wherein business advocates with the state for changes in public policy that may benefit the business yet its core motivation being public interest.

London Benchmarking Group (LBG) model

The LBG seeks to develop and expand the reporting of company activities in the community so that they are more transparent and can be evaluated by the impact they make. The group, which consists of some of the leading companies working in the UK, has devised the LBG model to classify what companies do in the community by their motivation, through philanthropy, Social Investment, Commercial Initiatives and Business Basics. The LBG has also laid down a methodology to measure and report on inputs (cash, kind and time) and outputs (classified as leverage, social impact and business impact) of corporate community involvement.

Corporate Citizenship Company (CCC) Framework

The Corporate Citizenship Company (CCC) an UK-based organisation advises on the issue of social responsibility. Based on its own experience in the field, its model looks at corporate citizenship as consisting of the following three components in descending order of importance:

(i) The basic values, policies and practices of a company's owned and operated business, at home and abroad.

(ii) The management of environmental and social issues within the value chain by business partners, from raw material production to product disposal.

(iii) The voluntary contributions made by a company to community development around the world.

The CCC model goes on to unpack the Business Basics component of the LBG model by analyzing and reporting to and about the following key stakeholders:

- *Employees (including contract and part-time)* : wage levels, accident rates, training budget, handling downsizing, etc.
- *Customers* : The price and value of goods and services, quality issues, how complaints are handled and values broadcast in advertising.
- *Investors* : The return on investment, corporate governance, directors share dealings and transparency in financial information.
- *Business partners* : The jobs sustained, the transfer of technology and the timely payment of bills.
- *The community* : Charitable gifts and community investment, the willingness to listen and engage in dialogue.
- *Government* : The payment of taxes, a fair transfer pricing policy and compliance with financial and other laws and regulations.
- The environment (or future generations and, increasingly, other living beings).

The CCC model also expands on the Corporate Responsibility in the Value Chain. Just like companies are being asked to report on the environment impact they are being similarly asked to report on their social impact.

Boston College Centre for Corporate Community Relations Standards of Excellence in Corporate Community Involvement

The Standards of Excellence in Corporate Community Involvement developed by the Boston College Centre for Corporate Community Relations provide management and operational guidelines, principles, policies, practices and measures to help Companies develop and manage world-class corporate community involvement. These standards require the companies to ensure that :

(i) Senior executives demonstrate support, commitment and participate in community involvement efforts.

(ii) The company identifies and monitors issues important to its operation and reputation.

(iii) Company management recognizes that building and maintaining relationships of trust with the community is a critical component of company strategy and operations.

(iv) The company develops and implements a strategic plan for community programmes and responses that is based on mutual issues, goals and concerns of the company and the community.

(v) All levels of the organisation have specific roles and responsibilities meeting community involvement objectives.

(vi) The company incorporates systems and policies to support, community and institutionalize community, involvement objectives.

(vii) The company establishes an ongoing process of evaluating community involvement strategies, activities and programs, and their impact on company and the community.

III. THE CORPORATE RESPONSE

Companies are responding to the issues of CSR and business accountability by adopting codes of behaviour that are transparent and fair not only to their shareholders but also to the general public and to other operators in directly involved in their activities. More and more companies are now publishing information on their social performance in order to demonstrate to their stakeholders that they are ethical, moral and accountable. Furthermore, the business and financial world is increasingly convinced that a positive financial bottom line is not necessarily the only indicator of a sustainable corporate future. A company's overall performance should be measured in an integrated way based on its combined contribution to economic prosperity, environmental quality and social capital, the so-called Triple Bottom Line approach.

IV. CASE STUDIES

GENERAL MOTORS

GM and the GM Foundation are committed to the Communities. Company's philanthropic and corporate relations mission is to ensure that the leadership position as a valued, responsible corporate citizen is maintained by enhancing the quality of life in the communities in which company operate.

Education : GM has a long standing commitment to education. The company believes quality education as vital to the future of American industry. GM provides funding at elementary through post-doctoral level. Many of the programmes receiving company's support are designed to create educational opportunities for minorities.

Health and Human Services : Cancer Research is the key philanthropic priority for the company. The company established GM Cancer Research Foundation to honour basic scientists and clinical scientists throughout the world, selected for demonstrated achievements in research on the causes, prevention and treatment of Cancer.

Civic and Community : The GM Foundation supports organizations that strengthen community awareness and improvement.

Environmental & Energy : The Company supports a variety of environmental organizations whose objects, goals and activities are aligned with the company's environmental principles. Special consideration is given to organizations that are internationally recognized and support programmes that have a worldwide scope, applicability and/or multinational advocacy, irrespective of national origin. Company also seeks to support organizations that advocate and approach that seeks solutions to unite economic, social and environmental goals.

Art and Culture : Over the years, GM Foundation has been a major contributor to a variety of art and cultural institutions. The G M Foundation continues to support these organizations in company's efforts to promote awareness of the arts, appreciation for diverse cultures and implementation of arts in education programmes.

HSBC

The company is involved in the well-being of the communities through philanthropy and sponsorship. Education, particularly for those less fortunate in society, and the environment are two principal causes for the company. Members of HSBC are expected to allocate 75 per cent of their donations and non-commercial sponsorship budgets to those activities with the greater emphasis on educational initiatives which include :

— Primary and secondary schooling for under-privileged children or support for schools in economically deprived areas ;

— Programmes to promote international understanding among young people;

— Activities that promote interest in and sensitivity to other cultures;

— Languages programmes, particularly the learning of Asian languages;

— Programmes which encourages youth to have a greater understanding of business and finance.

These activities are supplemented by direct support for other good causes. Company also encourage its staff to help raise money for charity and to do volunteer work.

Citi Group

Citi group believes that working to conserve and enhance the environment enables the company to operate more efficiently and contributes to the overall success of its business and to those of its clients. The company carefully reviews its operations to identify any environmental risks or benefits involved and implements policies accordingly.

Citi group employees across the United States log thousands of hours each year volunteering in their communities. They get involved through large company sponsored projects, as well as through individual causes that address special needs in their hometowns.

Citi group Foundation has provided Habitat for Humanity with a special $1 million grant to launch the Citigroup Builds Communities 2000 programme. Through this programme, Habitat homes will be constructed across the US by employees volunteer teams from various Citi group business units.

Citi group supports the National Academy Foundation, an organisation that combines resources from business, government and education to establish special programmes in selected high schools that focus on preparing students for careers in specific industries. In 1999, the Naitonal Academy Foundation and its local programmes received a total $1.65 million in grants from Citi group Foundation.

Toyota

Toyata believes that helping people improves the quality of life in their communities is an essential corporate responsibility. Education is the focus of Toyota's financing, with emphasis on primary and secondary schooling. In addition to funding national programmes, Toyota supports the social well-being of communities where it has major operations.

Toyota prefers to support programmes, rather than sponsor events. Organsiations must apply each year to the contributions programme, and subsequent funding is contingent upon evaluation of previous activities.

Boeing

The Company is committed to improving the quality of life in the communities in which it operates. By partnering with the local communities in more than 27 States and two countries, the company has strengthened ties that keep communities the vibrant places they should be.

Developing and maintaining healthy communities is so important to Boeing that company have included it as part of its mission called Vision 2016.

Company provide a safe workplace, protect the environment and promote the health and well-being of Boeing people and their families. Company work with communities by volunteering the financially supporting education and other worthy causes.

Good corporate citizenship is a key component of the Boeing Company. The commitment is simple: to support and improve the communities in which our employees live and work. Company ensures that communities are healthy. Healthy communities are well educated and have diverse cultural values, are economically viable, environmentally safe, and promote the well being and safety of their citizens. To help foster those qualities, Boeing focuses its charitable giving in four main areas; education, health and human services, culture and the arts, and civic and environmental issues. While most contributions are made in the communities where Boeing people work or live, on some occasions Boeing makes contributions to organisations that operate across a nation or around the globe.

Vodafone Group PLC

Vodafone is developing a corporate community investment programme which reflects the ambitions and values of its business. To make social investment as effective as possible the company focus on projects in two main areas – education and enterprise, and health and welfare.

Vodafone depend upon our employees. Everyone who works contributes to the reputation and the success of the company. It believes in investing in people because it is only by working together as a well-trained and resourced team that create new and exciting opportunities for business.

The Vodafone Group operates an equal opportunities policy within its businesses worldwide for all aspects of employment, regardless of race, colour, ethnic or national origin, sex, religion, marital status or disability.

Vodafone is committed to ensuring the health, safety and welfare of employees so far as is reasonably practicable. It apply high standards throughout the organization in the management and control of operations.

Continuing education, training and development are important elements in ensuring the future success of Vodafone. Policies have been adopted to assist employees in reaching their full potential.

Environmental considerations are not separate from core business but form part of overall business strategy. The company is committed to our strategic approach to green procurement, not least because such an approach offers financial as well as environmental advantages.

V. CORPORATE CITIZENSHIP – INDIAN PERSPECTIVE

The term corporate citizenship is the reincarnation of the concept of corporate social responsibility.

In India, the corporate social responsibility was perhaps first discussed in 1965 at an international seminar on social responsibility of business, which was inaugurated by the then Prime Minister, Late Shri Lal Bahadur Shastri. The seminar issued a declaration and defined social responsibility of business as 'responsibility to customers, workers, shareholders and the community'. The declaration co-related Gandhian concept of trusteeship with social responsibility of business.

In the development of corporate ethics, we have reached a stage where the question of social responsibility of business to the community can no longer be scoffed at or taken lightly.

Shri George Goyder, the author of 'Responsible Company' while delivering the C.C. Desai Memorial Lecture on February 18, 1978, reiterated that if the Corporation has to function effectively, it has to be accountable to the public at large. He equated the suggestion of a responsible company with the trusteeship concept advocated by Gandhiji, the aim of which was to ensure that private property is used for the common good.

As at the end of December 2001, there were a total of 5,84,184 companies, of which 5,07,906 were private companies and 76,278 public companies. Number of Government companies was 1,262 and non-Government companies were 5,82,922. The estimated paid-up capital of all companies was Rs.3, 39,801.6 crores.

It will be appreciated that with so-much public amount involved and so many lakhs of employees the companies can no longer be accepted as a private domain, the working of which would be of no concern to the society. On the contrary, the very impact of the corporate sector in terms of finance and employment shows that the well being of the corporate sector is of considerable significance to the society. This is because the well being of corporate sector has vital effect on the employment and economy of the community and the health of the society.

Sachar Committee on Social Responsibilities of Companies

The Sachar Committee in its Report observed that in the environment of modern economic development, corporate sector no longer functions in isolation. If the plea of the companies that they are performing a social purpose in the development of the country is to be accepted, it can only be judged by the test of social responsiveness shown to the needs of the community by the companies. The company must behave and function as a responsible member of the society just like any other individual. It cannot shun moral values nor can it ignore actual compulsions. The real need is for some focus on accountability on the part of the management not being limited to shareholders alone. In the modern times, the objective of business has to be the proper utilization of resources for the benefit of others. A profit is still a necessary part of the total picture but it is not the primary purpose. This implies that the claims of various interests will have to be balanced not on the narrow ground of what is best for the shareholders alone but from the point of view of what is best for the community at large. The company must accept its obligation to be socially responsible and to work for the larger benefit of the community.

The Committee recommended that the acceptance of the concept of social responsibility must be reflected in the information and disclosure that the company makes available for the benefit of the various constituents like shareholders, creditors, workers and the community.

It is recognized that management must operate with regard to the needs of the society and indeed of a nation as a whole. Survival with public sanction and growth seems to be more proper objective and these are possible only if the organization satisfies the needs of its public. Necessity to obtain willing co-operation from employees for their own benefit and progress as well as that of the organization is accepted. Providing safe working conditions and agreeable work relation programme, a training programme to develop employees' talents and of their children are accepted. Management must also participate increasingly in many community and social services. No enlightened management can remain aloof to the national problems such as unemployment, over-population, rural development, environmental protection including the conservation of resources, control of pollution and provision for clean drinking water. Corporate sector must accept the fact that although profits are indicative of sound business health, contribution to social progress is equally becoming a measure of corporate achievement. Business and industry have knowledge and skills which should be a powerful force in the solution of these various problems facing the society.

The Committee recommended the publishing of a social report by the company along with the director's report in quantitative terms. The emphasis which the Committee laid was on what the company would have done during the period under report in discharging its social responsibility. It must be emphasized that social responsibility is not limited to actions taken but also extend to specific non-actions which result into deleterious effects for the society.

Corporate Citizenship – Tata Code of Conduct

The Code of Conduct adopted by Tata Group of Companies provides that a Tata Company shall be committed to be a good corporate citizen not only in compliance with all relevant laws and regulations but also by actively assisting in the improvement of the quality of life of the people in the communities in which it operates with the objective of making them self reliant.

Such social responsibility would comprise, to initiate and support community initiatives in the field of community health and family welfare, water management, vocational training, education and literacy and encourage application of modern scientific and managerial techniques and expertise.

This will be reviewed periodically in consonance with national and regional priorities. The company would also not treat these activities as optional ones but would strive to incorporate them as integral part of its business plan. The company would also encourage volunteering amongst its employees and help them to work in the communities. Tata companies are encouraged to develop social accounting systems and to carry out social audit of their operations.

CII – Social Code

Confederation of Indian Industry (CII) recognizes that business organizations in addition to being economic entities engaged in the pursuit of profit through fair competition need to be useful to society as a whole. The Social Code devised by CII requires members to accept voluntarily the Code in application of the fact that the corporate citizenship can best be addressed through a professional approach to socially oriented programmes outside the limits of business operations. The Code suggest that -

— Member companies could evolve an explicit policy, and focus on community development.

— Social responsibility could be treated as an integral part of the business plans of member companies, wherein specify annual programs on community development are budgeted.

— Member companies could consider including their Social Development Plan in their board meeting agenda and review them regularly.

— Member companies could consider earmarking a part of their income every year for development programs as desirable. Commitments of both financial and management recourses/expertise for general awareness, education and training are equally important for development programs.

— Member companies to appreciate that Corporate Citizenship is not only in their own interest, but also in the interest of share holders, employees, customers, suppliers and the community within which they operate.

— Member companies could consider sensitizing their employees by involving them in social awareness programs for development and continuous improvement through innovative implementation.

— Member companies could develop proper schemes to identify and recognize the good work done by their employees so that volunteerism could be encouraged and benchmarked for improvement.

— Member companies to appreciate that there is considerable scope for involving external agencies non-Government organizations, bilateral and multilateral agencies, and Government welfare departments for their socially oriented programs as these are valuable resources for information, data, suggestions etc.

— Member companies to appreciate that there is also considerable scope of learning from each other in their role of being good Corporate citizens. Members could consider exchange of data, views, implementation procedures and even exchange of expert personnel whenever necessary.

— Member companies could work closely with the local community and involve them in all their efforts, so as to make the project people participatory.

— Member companies to be sensitive and respect the cultures and customs of the society in all their operations.

— CEOs of Member companies to recognize and take the initiative to make the spirit of the Social Code a reality and to set an example in cultivating corporate ethics.

VI. SURVEY OF CORPORATE INVOLVEMENT IN SOCIAL DEVELOPMENT IN INDIA

Report of the survey of 600 companies conducted by Social and Rural Research Institute, Indian Market Research Bureau and published by Partners in Change, New Delhi shows that social development as a responsibility of companies is not alien to corporate culture in India. The survey provides following information —

Relevance of Corporate Social Responsibility : More than 85% companies recognized their role in social development.

Ways of Contribution : Ways of contributing to social development include work for customer satisfaction; help to rural people, infrastructure, plantation/ environment/pollution control; donating money; helping the down trodden; medical help; help in education; increase employment.

Beneficiaries of Social Development Activities : Community was mentioned as one of the beneficiaries by 70% companies.

Companies having Policy on Social Responsibility : Older companies, Companies with higher turnover, and Companies with presence in both urban and rural areas, were more likely to have formulated a policy on social development

Survey indicated that there have been an increase from 8% in 1997 to 11% in 1999, of companies having a written policy.

Social Development Activities : Nearly 70% of the companies undertake social development activities. Companies having a policy were involved in Health and Education, Companies without a policy were more likely to involve in Infrastructure, Beautification/Traffic related issues.

Problem of Implementing Social Development Activities: The companies which were surveyed found, Government Policies; increasing community expectations; lack of people with required orientation; and time delays due to NGOs own priorities, as problems of implementing social development activities.

Budgetary Allocation of Funds : More than 40 years old companies were more likely to make provision in budget; proportion of companies making a provision is significantly higher in companies which were more than 40 years old; nearly 25% companies with turnover below 100 crore were making provision in budget; more than 40% companies with turn over between 100 – 500 crore were making provision in budget; more than 55% companies with turnover more than 500 crore were making budget provisions.

VII. CASE STUDIES

Voltas Limited

Community Development and Environmental Protection :The company laid emphasis on Community Development as well as ecology and environmental protection. The Company through a public charitable trust, Voltas Organization for Women (VOW) served the distressed people and through the Tata Council for Community Initiatives (TCCI) infrastructure contributed both money and services of specialists towards development projects.

The company has supported various projects. These include —

(i) Glaucoma-Prevention of Blindness Project undertaken by the National Association for the Blind at Glaucoma Control Centre, Khetwadi, Mumbai.

(ii) The Mumbai Malaria Control Programme, a project undertaken by the UN through IMPACT India.

(iii) The Voltas Organisation of Women disbursed over Rs.200,000 to 40 needy people for education and medical relief.

(iv) Vocational Training Programme — Akanksha Sewing Classes for empowerment of around 35 underprivileged teenage girls to earn a livelihood.

(v) Computer Literacy Training for around 35 needy children given in a Municipal School in Bandra.

(vi) Voltas contributed to Jamshedji Tata Trust towards Gujarat Cyclone Relief and blankets were also distributed to victims.

(vii) The company has supported a part-time diploma course in Air conditioning and Refrigeration.

(viii) National Association for Disabled Enterprises (NADE) had imparted professional expertise in the fields of finance and plant management.

The Company's factories give special emphasis to the environment through effective pollution control measures, tree planting and treatment of all waste materials.

Grasim Industries Ltd.

Community Involvement :To qualitatively impact the life of the weaker sections of society, company has engaged in a series of welfare driven initiatives. These are carried out under the aegis of "The Aditya Biria Centre for Community Initiatives and Rural Development", the company's vision is "To actively contribute to the social and economic development of the communities in which it operate. In so doing, build a better, sustainable way of life for the weaker sections of society".

As a part of social responsibility and as a good corporate neighbour, the company always strives to demonstrate its concern for society, by taking up projects in the vicinity of its complexes, to improve the quality of life of the people through legally constituted trusts and welfare bodies. Noteworthy efforts in the area of community development work include supply of potable water, contribution towards construction of school buildings, construction of all-weather roads, financial support to balwadies, health services, etc. Apart from this, financial assistance is also provided to various voluntary organizations engaged in social upliftment. The Company is also contributing a part of the sales-tax incentives every year to Gokul Gram Yojna.

Compay's far-ranging activities span a host of villages, crisscrossing the country focussing on health-care, sustainable livelihood and education.

Medical Camps : To provide healthcare to villagers in the nook and corner of the villages surrounding company's units, the company organized medical camps.

The physically impaired are also serviced by the company. Company's team of doctors examine the extent to which their disability can be reduced. Depending on their affliction, they are provided with tricycles, callipers, crutches, artificial limbs, and special shoes.

Spreading Literacy : To raise the literacy level in the areas around the company's Plants, the company has taken recourse to various ways, like setting up of adult education centres, and "balwadis', which are non-formal education centres.

To encourage and imbibe values among students, Biria Cellulosic have evolved the "Jivan Utkarsh Shibir". These are residential camps organized during the summer where students are given an orientation into basic values such as honesty, integrity, simplicity, perseverance which are all character forming. Additionally, they are given guidance on career planning.

To encourage girl students, special scholarships are offered at many of the Units. The company is involved in developing the infrastructure for rural schools in Reddipalaym, ostensibly one of the most backward areas in Tamil Nadu.

In collaboration with the District Education Department, the company organized Teachers Training programmes at Vikram Ispat. The teachers were drawn from the schools in the villages.

Women Empowerment Projects : To empower women through attaining financial independence, company train them in various vocations.Company's carpet, weaving project at Athana, spearheaded by Vikram Cement is growing from strength to strength. Besides giving meaningful employment opportunities to more than 50 of the poorest women, it has instilled in them a deep sense of pride, as their carpets increasingly find the acceptance of global customers.

Aditya Cement have initiated the skill Development Training Programme for women below the poverty line.

Towards Sustainable Livelihood

Farmer Focus

— Acting as a catalyst, the company's teams narrow in on farmers who can avail of the economic programmes launched by the Government. The team then assist the farmer in accessing the necessary funds which go towards enhancing their yield. The farmer is thus assured of a sustainable income, given a normal monsoon.

— To boost agricultural and horticultural activities, the company reaches out to thousands of' farmers in manifold ways.

— To enable villagers have a sustainable livelihood, hundreds of them have been trained in cottage industries as well.

Village Development Schemes : The company aims to embed the villages with at least the basic amenities, such as providing support towards better infrastructure through construction of roads, check-dams, drains and the repair of buildings which house the panchayats.

Changing face of villages : At Nagda, company has taken the challenging task of converting the village of "Nayan" into a model village. Under this project a Community Hall-cum-Training Centre has been established. The Centre serves as a Balwari, reading room cum library, a Sewing Centre and hub for cultural activities. Decent sanitation facilities have been provided as well.

Under the Swasthi Gram Yojana, the Malkhed Village, is making remarkable progress. Among collective accomplishments are providing water supply, constructing toilets, cementing and tarring of the roads, plantation in the village, soil conservation in the farmer's lands, and constructing a small two room school in the centre of the village.

Garnering Development Aid : For the year 1999-2000, the company mobilized over Rs. 1900 lakhs while in the year 2000-2001 it mobilized over Rs.2,000 lakhs through different development programmes. This is apart from company's own contribution. Company influenced the lives of 50,000 people directly, by ensuring their well-being physically, and for many others a sustainable means of livelihood.

Environment Protection : The company firmly believe in sustainable development and fully appreciate that the earth's resources and its capacity to absorb pollution and regenerate are finite. Therefore, operations at all Units of the company are conducted in a manner that respects the ecological balance.

The environmental dimension forms an integral part of all business decisions of the company. Pollution prevention, product stewardship and clean technologies enable the company to fulfil its goal of sustainable development.

The company clearly spelt out production norms that enable it to run its operations in an Eco-efficient manner. These revolve round:

— Adoption of cleaner technologies.

— Designing products and processes with as little environment impact as possible,

— Optimising resource efficiency in plant operations to minimise waste while maximising treatment of inevitable wastes in an environmentally compatible manner.

To achieve these goals, environment protection systems and processes are well in place. To meet the challenge of environment protection in a proactive manner, unavoidable wastes are dealt with in the most efficient and scientific way.

Bajaj Auto Limited

Rural development : The company continues its rural development activities through Jankidevi Bajaj Gram Vikas Sanstha (JBGVS). JBGVS makes concentrated efforts for the integrated development of 25 villages in Khedand Maval Talukas of Pune district and 6 villages in Gangapur and Paithan Talukas of Aurangabad district. Stress is laid on active participation by the villagers and development of local leadership, with JBGVS acting as a catalyst.

JBGVS took over the community development activities of Samaj Seva Kendra, Akurdi. JBGVS, in association with Council for Advancement of People's Action and Rural Technology (CAPART) supported a programme for dairy development in village Saindane Thakarwadi in Khed Taluka and the first phase of the project has been completed.

Drinking water schemes were implemented with government support in 3 villages; none of the villages where JBGVS works a re now tanker-fed in summer. Eight bore wells were constructed in Salumbra area in collaboration with Rotary Clubs of Dundee and Poona North. 32 students of the College of Agriculture, Pune were attached for 6 months to 5 villages where JBGVS works for gaining practical knowledge as well as imparting modern technology to the villagers.

BSES Limited

The company continued to contribute to community welfare measures and took up several initiatives. The company requested quickly in restoring electricity in affected areas of the State of Gujarat after devastating earthquake and it also organized a drive to collect relief material in Mumbai.

The company also took up the task to construct more than 600 houses, on no profit basis, in one of the affected town welfare organization and also constructed a community centre and a secondary school from the contributions from its employees and matching contribution from the company.

Besides these, the company has also taken several steps to adequate medical facilities to the needy people viz., 100 bed municipal hospital is in an advanced stage of completion; ambulance facility to charitable institution; participating in pulse polio programme by providing transportation facilities; organized an eye camp.

VIII. ISSUES FOR DELIBERATIONS

It is well established that those companies which are socially responsive are more successful and enjoy reputation and goodwill of the society. While Indian corporates are traditionally socially responsible and have demonstrated their concern for social upliftment, there are very few such companies which have made a mark in this area of their responsibility as a corporate citizenship. Hence, the concept of corporate citizenship need to be given a fresh look keeping in view the globalisation of Indian corporate sector. In this context, the issues which need deliberation and attention of the corporates, Government and the policy makers may be summarised as follows :

1 Is there sufficient conceptual clarity of the Corporate Social Responsibility ?

2. Is there a sufficient clarity upon the theories behind the formation of companies and the stakeholders in the working of companies ? Are the stakeholders merely the employees or the society at large ?

3. Is Corporate Social Responsibility mere social responsiveness or does it incorporate social responsibility ?

4. What shall be the goal of good Corporate Governance ? Is it profit maximisation or social interest and stakeholder interest to be considered ?
5. Should the effects be seen from the short-term or long-term vantage point ?
6. How corporation can be made responsive to the environmental issues facing the society today ?
7. Should Corporate Social Responsibility be regulated ? If yes, what should be the *modus operandi* of the regulation of the Corporate Social Responsibility ? Should the regulation be mandatory or regulatory ?
8. Should the level of regulation be national or international ? At the international level who should be entrusted with the task of regulating them ?
9. How can the transnational corporations be made more accountable towards the society?
10. How to make the companies socially accoutnable ?
11. What should be the yardstick to measure the Corporate Social Responsibility ?
12. What is the extent to which the Corporate Social Responsibility be allowed ?
13. What are the legal hurdles in Corporate Social Responsibility ? How to remove them?

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AN OVERVIEW OF THE SECURITIES MARKET IN INDIA

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INTRODUCTION

Transfer of resources from those with idle resources to others who have a productive need for them is perhaps most efficiently achieved through the securities markets. Stated formally, securities markets provide channels for allocation of savings to investments and thereby decouple these two activities. As a result, the savers and investors are not constrained by their individual abilities, but by the economy's abilities to invest and save respectively, which inevitably enhances savings and investment in the economy.

MARKET SEGMENTS

The securities market has two interdependent and inseparable segments, the new issues (primary market) and the stock (secondary) market. The primary market provides the channel for sale of new securities while the secondary market deals in securities previously issued. The price signals, which subsume all information about the issuer and his business including associated risk, generated in the secondary market, help the primary market in allocation of funds. The issuers of securities issue (create and sell) new securities in the primary market to raise funds for investment and/or to discharge some obligation. They do so either through public issues or private placement. It is a public issue if any body and everybody can subscribe for the securities. If the issue is made to select people, it is called private placement. In terms of the Companies Act, 1956, an issue becomes public if it results in allotment to more than 50 persons. This means an issue resulting in allotment to less than 50 persons is private placement. There are two major types of issuers who issue securities. The corporate entities issue mainly debt and equity instruments (shares, debentures, etc.), while the governments (central and state governments) issue debt securities (dated securities, treasury bills).

The secondary market enables participants who hold securities to adjust their holdings in response to changes in their assessment of risk and return. They also sell securities for cash to meet their liquidity needs. The secondary market has further two components, namely the over-the-counter (OTC) market and the exchange-traded market. OTC is different from the market place provided by the Over The Counter Exchange of India Limited. OTC markets are essentially informal markets where trades are negotiated. Most of the trades in government securities are in the OTC market. All the spot trades where securities are traded for immediate delivery and payment take place in the OTC market. The exchanges do not provide facility for spot trades in a strict sense. Closest to spot market is the cash market where settlement takes place after some time. Trades taking place over a trading cycle, i.e. a day under rolling settlement, are settled together after a certain time (currently 3 working days). All the 23 stock exchanges in the country provide facilities for trading of equities. Trades executed on the leading exchange (NSE) are cleared and settled by a clearing corporation which provides novation and settlement guarantee. Over 99% of the trades settled by delivery are settled in demat form. NSE also provides a formal trading platform for trading of a wide range of debt securities including government securities.

A variant of secondary market is the forward market, where securities are traded for future delivery and payment. Pure forward is out side the formal market. The versions of forward in formal market

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are futures and options. In futures market, standardised securities are traded for future delivery and settlement. These futures can be on a basket of securities like an index or an individual security. In case of options, securities are traded for conditional future delivery. There are two types of options – a put option permits the owner to sell a security to the writer of options at a predetermined price while a call option permits the owner to purchase a security from the writer of the option at a predetermined price. These options can also be on individual stocks or basket of stocks like index. Two exchanges, namely NSE and BSE provide trading of derivatives of securities.

PRODUCTS AND PARTICIPANTS

Savings are linked to investments by a variety of intermediaries through a range of complex financial products called "securities" which is defined in the Securities Contracts (Regulation) Act, 1956 to include shares, scrips, stocks, bonds, debentures, debenture stock, or other marketable securities of like nature in or of any incorporate company or body corporate, government securities, derivatives of securities, units of collective investment scheme, security receipts, interest and rights in securities, or any other instruments so declared by the central government. There are a set of economic units who demand securities in lieu of funds and others who supply securities for funds. These demand for and supply of securities and funds determine, under competitive market conditions in goods and securities market, the prices of securities.

It is not that the suppliers of funds and suppliers of securities meet each other and exchange funds for securities. It is difficult to accomplish such double coincidence of wants. The amount of funds supplied by the supplier of funds may not be the amount needed by the supplier of securities. Similarly, the risk, liquidity and maturity characteristics of the securities may not match preference of the supplier of funds. In such cases, they incur substantial search costs to find each other. Search costs are minimised by the intermediaries who match and bring these suppliers together. They may act as agents to match the needs of the suppliers of funds / securities, help them in creation and sale of securities or buy the securities issued by supplier of securities and in turn, sell their own securities to suppliers of funds. It is, thus, a misnomer that securities market disintermediates by establishing a direct relationship between the suppliers of funds and suppliers of securities. The market does not work in a vacuum; it requires services of a large variety of intermediaries like merchant bankers, brokers, etc (Table 1) to bring the suppliers of funds and suppliers of securities together for a variety of transactions. The disintermediation in the securities market is in fact an intermediation with a difference; it is a risk-less intermediation, where the ultimate risks are borne by the suppliers of funds/securities (issuers of securities and investors in securities), and not the intermediaries.

Table 1

Market Participants in Securities Market

Market Participants	*Number as on March 31, 2002*
Securities Appellate Tribunal	1
Regulators (DEA, DCA, SEBI, RBI)	4
Depositories	2
Stock Exchanges	23
Brokers	9,687
Sub-brokers	12,208
FIIs	490
Portfolio Managers	47
Custodians	12
Share Transfer Agents	161
Primary Dealers	18
Merchant Bankers	145
Bankers to an Issue	68
Debenture Trustees	40
Underwriters	54
Venture Capital Funds	34
Foreign Venture Capital Investors	2
Mutual Funds	37
Collective Investment Schemes	6

Source: SEBI

The securities market, thus, has essentially three categories of participants, namely the issuers of securities, investors in securities and the intermediaries and two categories of products, namely the services of the intermediaries and the securities, including derivatives. The issuers and investors are the consumers of services rendered by the intermediaries while the investors are consumers of securities issued by issuers. Those who receive funds in exchange for securities and those who receive securities in exchange for funds often need the reassurance that it is safe to do so. This reassurance is provided by the law and custom, often enforced by the regulator. The regulator develops fair market practices and regulates the conduct of issuers of securities and the intermediaries so as to protect the interests of investors in securities. The regulator ensures a high standard of service from intermediaries and supply of quality securities and non-manipulated demand for them in the market.

A PROFILE

The past decade in many ways has been remarkable for securities market in India. It has grown exponentially as measured in terms of amount raised from the market, number of stock exchanges and other intermediaries, the number of listed stocks, market capitalisation, trading volumes and turnover on stock exchanges, and investor population. The market has witnessed fundamental institutional changes resulting in drastic reduction in transaction costs and significant improvements in efficiency, transparency and safety.

Dependence on Securities Market

Three main sets of entities depend on securities market. While the corporates and governments raise resources from the securities market to meet their obligations, the households invest their savings in securities. While the corporate sector and governments together raised a sum of Rs. 226,911 crore during 2001-02, the household sector invested 4.3% of their financial savings through the securities market during 2000-01 (Tables 2 and 3).

Corporate Sector : The 1990s witnessed emergence of the securities market as a major source of finance for trade and industry. The share of capital market based instruments in resources raised externally increased to 53% in 1993-94, but declined thereafter to 31% by 2000-01.

Governments : Along with increase in fiscal deficits of the governments, the dependence on market borrowings to finance fiscal deficits has increased over the years. The state governments and the central government financed about 14% and 18% respectively of their fiscal deficit by market borrowings during 1990-91. In percentage terms, dependence of the state governments on market borrowing did not increase much during the decade 1991-2002. In case of central government, it increased to 69.4% by 2001-02.

Households: Household sector accounted for 89% of gross domestic savings during 2000-01; 53% of their savings were in financial assets. The share of financial savings of the household sector in securities (shares, debentures, public sector bonds and units of UTI and other mutual funds and government securities) is estimated to have gone down from 22.9% in 1991-92 to 4.3% in 2000-01.

Though there was a major shift in the saving pattern of the household sector from physical assets to financial assets and within financial assets, from bank deposits to securities, the trend got reversed in the recent past due to high real interest rates, prolonged subdued conditions in the secondary market, lack of confidence by the issuers in the success of issue process as well as of investors in the credibility of the issuers and the systems and poor performance of mutual funds. The portfolio of household sector remains heavily weighted in favour of physical assets and fixed income bearing instruments.

Table 2

Dependence on Securities Market

Year	*Share (%) of Securities Market in*			
	External Finance of Corporates	*Fiscal Deficit of Central Govern-ment*	*Fiscal Deficit of State Govern-ment*	*Financial Savings of House-holds*
1990-91	19.35	17.9	13.6	14.4
1991-92	19.17	20.7	17.5	22.9
1992-93	33.38	9.2	16.8	17.2
1993-94	53.23	48.0	17.6	14.0
1994-95	44.99	35.2	14.7	12.1
1995-96	21.67	54.9	18.7	7.7
1996-97	22.12	30.0	17.5	6.9
1997-98	28.16	36.5	16.5	4.5
1998-99	27.05	60.9	14.1	4.2
1999-00	33.58	67.1	13.9	7.3
2000-01	31.39	61.4	13.8	4.3
2001-02	N. A	69.4	15.2	N. A

Source : CMIE & RBI.

Table 3

Resource Mobilisation from the Primary Market

(Rs. crore)

Issues	*90-91*	*91-92*	*92-93*	*93-94*	*94-95*	*95-96*	*96-97*	*97-98*	*98-99*	*99-00*	*2000-01*	*2001-02*
Corporate Securities	14,219	16,366	23,537	44,498	48,084	36,689	37,147	42,125	60,192	72,450	78,396	74,403
Domestic Issues	14,219	16,366	23,286	37,044	41,974	36,193	33,872	37,738	59,044	68,963	74,199	72,061
Non-Govt.												
Public Co.	4,312	6,193	19,803	19,330	26,417	16,075	10,410	3,138	5,013	5,153	4,890	5,692
PSU Bonds	5,663	5,710	1,062	5,586	3,070	2,292	3,394	2,982	—	—	—	—
Govt. Companies	—	—	430	819	888	1,000	650	43	—	—	—	350
Banks & FIs	—	—	356	3,843	425	3,465	4,352	1,476	4,352	2,551	1,472	1,070
Private Placement	4,244	4,463	1,635	7,466	11,174	13,361	15,066	30,099	49,679	61,259	67,836	64,950
Euro Issues	-	-	702	7,898	6,743	1,297	5,594	4,009	1,148	3,487	4,197	2,342
Government Securities	11,558	12,284	17,690	54,533	43,231	46,783	42,688	67,386	106,067	113,336	128,483	152,508
Central Government	8,989	8,919	13,885	50,388	38,108	40,509	36,152	59,637	93,953	99,630	115,183	133,801
State Governments	2,569	3,364	3,805	4,145	5,123	6,274	6,536	7,749	12,114	13,706	13,300	18,707
Total	25,777	28,650	41,227	99,031	91,315	83,472	79,835	109,511	166,259	185,786	206,879	226,911
Mutual Funds	7508	11,253	13,021	11,243	11,275	-5,833	-2,037	4,064	3,611	19,953	11,135	8,024

Source: RBI.

Investor Population

The Society for Capital Market Research and Development carries out periodical surveys of household investors to estimate the number of investors. Their first survey carried out in 1990 placed the total number of share owners at 90-100 lakh. Their second survey estimated the number of share owners at around 140-150 lakh as of mid-1993. Their latest survey estimates the number of shareowners at around 2 crore at 1997 end, after which it remained stagnant upto the end of 1990s. The bulk of increase in number of investors took place during 1991-94 and tapered off thereafter. 49% of the share owners at the end of 2000 had, for the first time, entered the market before the end of 1990, 44% entered during 1991-94, 6.3% during 1995-96 and 0.8% since 1997. The survey attributes such tapering off to persistent depression in the share market and investors' bad experience with many unscrupulous company promoters and managements.

According to the SEBI-NCAER survey of Indian investors conducted in early 1999, an estimated 12.8 million, or 7.6% of all Indian households representing 19 million individuals had directly invested in equity shares and or debentures as at the end of financial year 1998-99. The investor households increased at a compound growth rate of 22% between 1985-86 and 1998-99. About 35% of investor households became investors in equity shares prior to 1991, while 47% of the investors entered the market between 1991 and 1995 and 17% after 1995. More than 156 million or 92% of all Indian households were non-investor households who did not have any investments in equity/debentures. Low per capita income, apprehension of loss of capital, and economic insecurity, which are all inter-related factors, significantly influenced the investment attitude of the households. The lack of awareness about securities market and absence of a dependable infrastructure and distribution network coupled with aversion to risk inhibited non-investor households from investing in the securities market.

An estimated 15 million (nearly 9%) of all households representing at least 23 million unit holders had invested in units of mutual funds. Total investible resources of mutual funds account for about 23% of market capitalisation compared to more than 50% in developed countries. The mutual funds have not yet become an attractive investment avenue for the low and middle-income groups.

Primary Market

Corporate Securities : Average annual capital mobilisation from the primary market, which used to be about Rs.70 crore in the 1960s and about Rs.90 crore in the 1970s, increased manifold during the 1980s, with the amount raised in 1990-91 being Rs. 4,312 crore. It received a further boost during the 1990s with the capital raised by non-government public companies rising sharply to Rs. 26,417 crore in 1994-95. The market, however, appears to have dried up since 1995-96 due to interplay of demand and supply side forces. In real terms, the amount raised by non-government public companies during 2001-02 is about 60% of the amount raised a decade back in 1990-91.

Many investors who were lured into the market during 1992-94 seem to be adopting a very cautious approach because of their frustration with some of the issuers and intermediaries associated with the securities market. They have not completely withdrawn from the market, but are looking for quality issues the availability of which has declined due to stricter eligibility criteria for public issues imposed by SEBI and the general slowdown in the economic activity. Simultaneously, issuers have shifted focus to other avenues for raising resources like private placement where compliance is much less. Available data (Table 3), although scanty, indicate that private placement has become a preferred means of raising resources by the corporate sector. It accounted for about 89% of total resources mobilised through domestic issues by the corporate sector during 2001-02. Rapid dismantling of shackles on institutional investments and deregulation of the economy are driving growth of this segment. There are several inherent advantages of relying on private placement route for raising resources. While it is cost and time effective method of raising funds and can be structured to meet the needs of the entrepreneurs, it does not require detailed compliance with formalities as required in public or rights issues. It is believed in some circles that private placement has crowded out public issues.

Indian market is getting integrated with the global market though in a limited way through euro issues. Since 1992, when they were permitted access, Indian companies have raised about Rs. 37,000 crore through ADRs/GDRs. By the end of March 2002, 490 FIIs were registered with SEBI. They had net cumulative investments over of US $ 15 billion by the end of March 2002.

The market is getting institutionalised as people prefer mutual funds as their investment vehicle, thanks to evolution of a regulatory framework for mutual funds, tax concessions offered by government and preference of investors for passive investing. The net collections by mutual funds picked up during 1990s and increased to Rs. 19,953 crore during 1999-2000 (Table 3). This, however, declined to Rs. 8,024 crore during 2001-02. Starting with an asset base of Rs. 25 crore in 1964, the total assets under management at the end of March 2002 was Rs. 100,594 crore. The number of households owning units of MFs exceeds the number of households owning equity and debentures.

Government Securities : The primary issues of the Central Government have increased many-fold during the decade of 1990s from Rs. 8,989 crore in 1990-91 to Rs. 133,801 crore in 2001-02 (Table 3). The issues by state governments increased by about five times from Rs. 2,569 crore to Rs. 18,707 crore during the same period.

Secondary Market

Corporate Securities : Selected indicators in the secondary market are presented in Table 4. The number of stock exchanges increased from 11 in 1990 to 23 now. All the exchanges are fully computerised and offer 100% on-line trading. 9644 companies were available for trading on stock exchanges at the end of March 2002. The trading platform of the stock exchanges was accessible to 9,687 members from over 400 cities on the same date.

Table 4

Secondary Market - Selected Indicators

(Amount in Rs. crore)

At the End of Financial Year	*Capital Market Segment of Stock Exchanges*							*SGL Turn over*	*Derivatives Turnover*
	No. of Brokers	*No. of Listed Companies*	*S&P CNX Nifty*	*Market Cap*	*Market Cap Ratio (%)*	*Turnover*	*Turnover Ratio (%)*		
1990-91	—	6,229	366.45	110,279	20.6	—	—	—	—
1991-92	—	6,480	1261.65	354,106	57.4	—	—	—	—
1992-93	—	6,925	660.51	228,780	32.4	—	—	—	—
1993-94	—	7,811	1177.11	400,077	45.6	203,703	50.9	—	—
1994-95	6,711	9,077	990.24	473,349	45.6	162,905	34.4	50,569	—
1995-96	8,476	9,100	985.30	572,257	47.0	227,368	39.7	127,179	—
1996-97	8,867	9,890	968.85	488,332	34.6	646,116	132.3	122,941	—
1997-98	9,005	9,833	1116.65	589,816	37.7	908,681	154.1	185,708	—
1998-99	9,069	9,877	1078.05	574,064	34.1	1,023,382	178.3	227,228	—
1999-00	9,192	9,871	1528.45	1,192,630	84.7	2,067,031	173.3	539,232	—
2000-01	9,782	9,954	1148.20	768,863	54.5	2,880,990	374.7	698,121	4,018
2001-02	9,687	9,644	1129.55	749,248	36.4	895,826	119.6	1,555,653	103,848

Note : Turnover figures for the respective year; — Information Not Available.

The market capitalisation grew ten fold between 1990-91 and 1999-2000. All India market capitalisation is estimated at Rs.749,248 crore at the end of March 2002. The market capitalisation ratio, which indicates the size of the market, increased sharply to 85% by March 2000. It, however, declined to 36% by end March 2002. Traditionally, manufacturing companies and financial services sector accounted for a major share in market capitalisation. However, in the recent past, the importance of these traditional sectors has declined and new sectors like, information technology, pharmaceuticals and fast moving consumer goods have picked up.

The trading volumes on exchanges have been witnessing phenomenal growth during the 1990s. The average daily turnover grew from about Rs.150 crore in 1990 to Rs. 12,000 crore in 2000, peaking at over Rs. 20,000 crore. One-sided turnover on all stock exchanges exceeded Rs. 10,00,000 crore during 1998-99, Rs. 20,00,000 crore during 1999-2000 and approached Rs. 30,00,000 crore during 2000-01. However, it declined substantially to Rs.895,826 crore in 2001-02. The turnover ratio, which reflects the volume of trading in relation to the size of the market, has been increasing by leaps and bounds after the advent of screen based trading system by the NSE. The turnover ratio for the year 2000-01 increased to 375 but fell substantially due to bad market conditions to 119 during 2001-02.

The relative importance of various stock exchanges in the market has undergone dramatic change during this decade. The increase in turnover took place mostly at the big exchanges and it was partly at the cost of small exchanges that failed to keep pace with the changes. NSE is the market leader with over 80% of total turnover (volumes on all segments) in 2001-02. Top 6 stock exchanges together accounted for 99.88% of turnover, while about a dozen exchanges reported nil turnover during the year. The big exchanges now report higher turnover from its trading terminals in the home turf of most of the corresponding regional exchanges.

The sectoral distribution of turnover has undergone significant change over last few years. The share of manufacturing companies in turnover of top '50' companies, which was nearly 80% in 1995-96, declined sharply to about 6% in 2001-02. During the same period the share of IT companies in turnover increased sharply from nil in 1995-96 to 67% in 2001-02.

Trades concentrate on a few securities/members, though decreasing concentration of trades is observed in the recent years. Top '5' and '100' securities accounted for 44% and 96% of turnover respectively during 2001-02. During the same period, top '5' and '100' members accounted for 7% and 53% of turnover respectively.

Many securities listed on stock exchanges are not traded and trading in many other securities is negligible. On an average about 25% companies at BSE were traded every month during 2001-02. Only 23.15% of companies traded on BSE were traded for more than 100 days during 2001-02. Trading took place for less than 100 days in case of 76.85% of companies traded at BSE during the year, and for less than 10 days in case of 24.76% of companies traded. On an average 93% of companies available for trading at NSE were traded every month during 2001-02. Nearly 78% of companies traded on NSE were traded for more than 100 days during 2001-02. There was no trade in several companies listed on a number of regional stock exchanges. This indicates that trading is concentrated among only a limited number of stocks and is very thin in a large number of stocks.

In the very first year of liberalisation, i.e. 1991-92, the S&P CNX NIFTY, the most widely used indicator of the market, recorded a growth of 267%, followed by sharp decline of 47% in the next year as certain irregularities in securities transactions were noticed. Since then, the market experienced a roller coaster ride till 1999-2000 when the Nifty firmed up by 42% due to perception about the strength of the government and its commitment towards second generation reforms, improved macroeconomic parameters and better corporate results. The trend got reversed during 2000-01, which witnessed large sell-offs in new economy stocks in global markets, deceleration in the growth of the domestic economy, market turbulence following allegations of large scale irregularities in securities transactions, and revelation of large scale corruption in the procurement of defence equipments. The trend precipitated further during 2001-02 with introduction of rolling settlement and withdrawal of deferral products in July 2002, suspension of repurchase facility under UTI's US-64 scheme, terrorist attack on World Trade Centre in September 2002, etc.

Government Securities : The aggregate turnover in central and state government dated securities, including treasury bills, through SGL transactions increased 31 times between 1994-95 and 2001-02. During 2001-2002 it reached a level of Rs.1,573,893 crore, higher than combined trading volumes in equity segments of all the exchanges in the country, reflecting deepening of the market. The share of outright transactions in government securities increased from 23.2% in 1995-96 to 77% in 2001-02. The share of repo transactions declined correspondingly from 76.8% in 1995-96 to 23% in 2001-02. The share of dated securities in turnover of government securities increased from 69% in 1996-97 to 94% in 2001-02. The T-bills accounted for remaining SGL turnover.

Derivatives Market

Derivatives trading commenced in India in June 2000. The total exchange traded derivatives witnessed a volume of Rs.103,848 crore during 2001-02 as against Rs. 4,018 crore during the preceding year. While NSE accounted for about 98% of total turnover, BSE accounted for less than 2% in 2001-02. The market witnessed higher volumes from June 2001 with introduction of index options, and still higher volumes with the introduction of stock options in July 2001. There was a spurt in volumes in November 2001 when stock futures were introduced. It is believed that India is the largest market in the world for stock futures.

MARKET DESIGN

Primary Market

Corporate Securities : The issue of capital to public by Indian companies is governed by the Disclosure and Investor Protection (DIP) Guidelines of SEBI. The guidelines provide norms relating to eligibility for companies issuing securities, pricing of issues, listing requirements, disclosure, lock-in period for promoters' contribution, contents of offer documents, pre and post issue obligations, etc.

Eligibility : An unlisted company can make public issue of equity shares or any other security convertible into equity shares, on fixed price basis or on book building basis, provided (i) it has a pre-issue net worth of not less than Rs. 1 crore in 3 out of the 5 preceding years, (ii) it has a track record of distributable profits for at least 3 out of the preceding 5 years, and (iii) the issue size does not exceed five times its pre-issue net worth. A listed company can access market upto five times of its pre-issue net worth. If the company, listed or unlisted, does not meet the above criteria, then the issue has to be compulsorily made through book building route with minimum offer of 60% of the issue size to 'Qualified Institutional Buyers'. Infrastructure companies are exempt from the eligibility norms if their project has been appraised by a public financial institution and not less than 5% of the project cost is financed by any of the institutions, jointly or severally, by way of loan and/or subscription to equity. Public and rights issues of debt instruments, irrespective of their maturities or conversion period, require credit rating. If the issue size exceeds Rs. 100 crore, credit rating from two rating agencies is mandatory. Thus the quality of the issue is demonstrated by track record/ appraisal by financial institutions/credit rating/ subscription by QIBs.

Pricing : An eligible company is free to make public/rights issue of securities of any denomination and at any price. It has option to determine price and justify the same in prospectus or may allow investors to determine the price through book building. In the former case, the price is known in advance to investor and the demand is known at the close of the issue. In case of public issue through book building, demand can be known at the end of everyday but price is known at the close of issue. An issuer company proposing to issue capital through book building has two options viz., 75% book building route and 100% book building route. In case 100% book building route is adopted, not more than 60% of net offer to public can be allocated to QIBs, not less than 15% of the net offer to the public can be allocated to non-institutional investors applying for more than 1000 shares and not less than 25% of the net offer to public can be allocated to retail investors applying for upto 1000 shares. In case 75% of net public offer is made through book building, not more than 60% of the net offer can be allocated to QIBs and not less than 15% of the net offer can be allocated to non-institutional investors. The balance 25% of the net offer to public, offered at a price determined through book building, are available to retail individual investors who have either not participated in book building or have not received any allocation in the book built portion.

Promoters' Contribution : The promoters' contribution in case of public issues by unlisted companies and promoters' shareholding in case of 'offers for sale' should not be less than 20% of the post issue capital. In case of public issues by listed companies, promoters should contribute to the extent of 20% of the proposed issue or should ensure post-issue holding to the extent of 20% of the post-issue capital. The promoters should bring in the full amount of the promoters contribution including premium at least one day prior to the issue opening date.

The lead merchant banker discharges most of the pre-issue and post-issue obligations. He satisfies himself about all aspects of offering and adequacy of disclosures in the offer document. He issues a due diligence certificate stating that he has examined the prospectus, he finds it in order and that it brings out all the facts and does not contain anything wrong or misleading. He also takes care of allotment, refund and despatch of certificates.

The admission to a depository for dematerialisation of securities is a prerequisite for making a public or rights issue or an offer for sale. The investors, however, have the option of subscribing to securities in either physical form or dematerialised form. All new IPOs are compulsorily traded in dematerialised form. Every public listed company making IPO of any security for Rs. 10 crore or more is required to do so only in dematerialised form. A company cannot make a public issue unless it has made an application for listing of those securities with stock exchange(s).

Government Securities : The issue is governed by the terms and conditions specified in the general notification of the government and also the terms and conditions specified in the specific notification issued in respect of issue of each security. Government issues securities with fixed coupon rates, floating rate bonds, zero coupon bonds and securities with embedded derivatives. The securities are issued through auction either on price basis or on yield basis.

Where the issue is on price basis, the coupon is pre-determined and the bidders quote price per Rs.100 face value of the security, at which they desire to purchase the security. Where the issue is on yield basis, the coupon of the security is decided in an auction and the security carries the same coupon till maturity. On the basis of the bids received, RBI determines the maximum rate of yield or the minimum offer price as the case may be at which offers for purchase of securities would be accepted at the auction. The auctions for issue of securities (on either yield basis or price basis) are held either on 'Uniform price' method or on 'Multiple price' method. Where an auction is held on 'Uniform price' method, competitive bids offered with rates up to and including the maximum rate of yield or the prices up to and including the minimum offer price, as determined by RBI, are accepted at the maximum rate of yield or minimum offer price so determined. Bids quoted higher than the maximum rate of yield or lower than the minimum price are rejected. Where an auction is held on 'Multiple price' method, competitive bids offered at the maximum rate of yield or the minimum offer price, as determined by RBI, are accepted. Other bids tendered at lower than the maximum rate of yield or higher than the minimum offer price are accepted at the rate of yield or price as quoted in the respective bid. Bids quoted higher than the maximum rate of yield or lower than the minimum price are rejected. Individuals and specified institutions (read 'retail investors') can participate in the auctions on 'non-competitive' basis. Allocation of the securities to non-competitive bidders are made at the discretion of RBI and at a price not higher than the weighted average price arrived at on the basis of the competitive bids accepted at the auction or any other price announced in the specific notification.

Secondary Market

Corporate Securities : The stock exchanges, recognized under the SCRA, are the exclusive centres for trading of securities. Though the area of operation/jurisdiction of an exchange is specified at the time of its recognition, they have been allowed recently to set up trading terminals anywhere in the country. The three newly set up exchanges (OTCEI, NSE and ICSE) were permitted since their inception to have nation wide trading. The trading platforms of a few exchanges are now accessible from many locations. Further, with extensive use of information technology, the trading platforms of a few exchanges are also accessible from anywhere through the Internet and mobile devices. This made a huge difference in a geographically vast country like India.

Exchange Management: Only 3 exchanges (Mumbai, Ahmedabad, Madhya Pradesh) are organised in the form of "Association of Persons", while the balance 20 are organized as companies – either limited by guarantee or by shares. Except one exchange (NSE), all exchanges, whether corporates or association of persons, are not-for-profit organizations.

Most of the stock exchanges in the country are organised as "mutuals" which was considered beneficial in terms of tax benefits and matters of compliance. The trading members, who provide brokering services, also own, control and manage the exchanges. This is not an effective model for self-regulatory organisations as the regulatory and public interest of the exchange conflicts with private interests. Efforts are on to demutualise the exchanges whereby ownership, management and trading membership would be segregated from one another. Two exchanges *viz*. OTCEI and NSE are demutualised from inception, where ownership, management and trading are in the hands of three different sets of people. This model eliminates conflict of interest and helps the exchange to pursue market efficiency and investor interest aggressively.

Membership : The trading platform of an exchange is accessible only to brokers. The broker enters into trades in exchanges either on his own account or on behalf of clients. No stock broker or sub-broker is allowed to buy, sell or deal in securities, unless he or she holds a certificate of registration granted by SEBI. A broker/sub-broker complies with the code of conduct prescribed by SEBI. Over time, a number of brokers - proprietor firms and partnership firms - have converted themselves into corporates. Out of 9,687 brokers registered with SEBI at the end of March 2002, 3,862 brokers, accounting for nearly 40% of total, were corporate entities. At end-March 2002, there were 12,208 sub-brokers registered with SEBI. The standards for admission of members stress on factors, such as corporate structure, capital adequacy, track record, education, experience, etc. and reflect a conscious endeavour to ensure quality broking services.

Listing : A company seeking listing satisfies the exchange that at least 10% of the securities, subject to a minimum of 20 lakh securities, were offered to public for subscription, and the size of the net offer to the public (i.e. the offer price multiplied by the number of securities offered to the public, excluding reservations, firm allotment and promoters' contribution) was not less than Rs. 100 crore, and the issue is made only through book building method with allocation of 60% of the issue size to the qualified institutional buyers. In the alternative, it is required to offer at least 25% of the securities to public. The company is also required to maintain the minimum level of non-promoter holding on a continuous basis.

In order to provide an opportunity to investors to invest/trade in the securities of local companies, it is mandatory for the companies, wishing to list their securities, to list on the regional stock exchange nearest to their registered office. If they so wish, they can seek listing on other exchanges as well. Monopoly of the exchanges within their allocated area, regional aspirations of the people and mandatory listing on the regional stock exchange resulted in multiplicity of exchanges.

The basic norms for listing of securities on the stock exchanges are uniform for all the exchanges. These norms are specified in the listing agreement entered into between the company and the concerned exchange. The listing agreement prescribes a number of requirements to be continuously complied with by the issuers for continued listing and such compliance is monitored by the exchanges. It also stipulates the disclosures to be made by the companies and the corporate governance practices to be followed by them. SEBI has been issuing guidelines/circulars prescribing certain norms to be included in the listing agreement and to be complied with by the companies.

A listed security is available for trading on the exchange. 9,644 securities were listed on exchanges at the end of March 2002. A security listed on other exchanges is also permitted for trading. The stock exchanges levy listing fees - initial fees and annual fees - from the listed companies. It is a major source of income for many exchanges.

A listed company can voluntary delist its securities from non-regional stock exchanges after providing an exit opportunity to holders of securities in the region where the concerned exchange is located. An exchange can, however, delist the securities compulsorily following a very stringent procedure.

Trading Mechanism : The exchanges provide an on-line fully-automated screen based trading system (SBTS) where a member can punch into the computer quantities of securities and the prices at which he likes to transact and the transaction is executed as soon as it finds a matching order from a counter party. SBTS electronically matches orders on a strict price/time priority and hence cuts down on time, cost and risk of error, as well as on fraud resulting in improved operational efficiency. It allows faster incorporation of price sensitive information into prevailing prices, thus increasing the informational efficiency of markets. It enables market participants to see the full market on real-time, making the market transparent. It allows a large number of participants, irrespective of their geographical locations, to trade with one another simultaneously, improving the depth and liquidity of the market. It provides full anonymity by accepting orders, big or small, from members without revealing their identity, thus providing equal access to everybody. It also provides a perfect audit trail, which helps to resolve disputes by logging in the trade execution process in entirety.

Trading Rules : SEBI has framed regulations to prevent insider trading as well as unfair trade practices. The acquisitions and takeovers are permitted in a well-defined and orderly manner. The companies are permitted to buy back their securities to improve liquidity and enhance the shareholders' wealth.

Price Bands : Stock market volatility is generally a cause of concern for both policy makers as well as investors. To curb excessive volatility, SEBI has prescribed a market wide circuit breaker system which brings about a coordinated trading halt in all equity and equity derivatives markets nation-wide, when the index moves either way by 10%, 15% and 20%. The movement of either S&P CNX Nifty or Sensex, whichever is breached earlier, triggers the breakers. As an additional measure of safety, individual scrip-wise price bands of 20% either way have been imposed for all securities. However, in respect of securities for which derivative products are available or those included in indices on which derivative products are available, a daily price limit of 10% is applicable.

Demat Trading : While the investors have a right to hold securities in either physical or demat form, SEBI has mandated compulsory trading and settlement of select securities in dematerialised form. All actively traded securities are currently held, traded and settled in demat form.

The securities of public limited companies are freely transferable subject to certain exceptions. Two depositories, *viz*. NSDL and CDSL, maintain ownership records of dematerialised securities in a book entry form and transfer ownership of securities electronically without making the securities move from person to person. 4,172 and 4,284 companies were connected to NSDL and CDSL respectively at the end of March 2002, when 56.5 billion securities with a value of Rs. 4,669 billion were held in demat form with the depositories. The depositories had nearly 5 million investor accounts on the same date. Demat settlement accounts for over 99% of turnover settled by delivery. This has almost eliminated the bad deliveries and associated problems.

Charges : A stock broker is required to pay a registration fee of Rs.5, 000 for every financial year, if his annual turnover does not exceed Rs. 1 crore. If the turnover exceeds Rs. 1 crore during any financial year, he has to pay Rs. 5,000 plus one-hundredth of 1% of the turnover in excess of Rs.1 crore. After the expiry of five years from the date of initial registration as a broker, he has to pay Rs. 5,000 for a block of five financial years. Besides, the exchanges collect transaction charges from its trading members. NSE levies Rs. 4 per lakh of turnover.

The maximum brokerage a trading member can levy in respect of securities transactions is 2.5% of the contract price, exclusive of statutory levies like SEBI turnover fee, service tax and stamp duty. However, brokerage charges as low as 0.15% are also observed in the market. This maximum brokerage is inclusive of the brokerage charged by the sub-broker which shall not exceed 1.5% of contract price.

Stamp duties are payable as per the rates prescribed by the relevant state. In Maharastra, it is charged @ Re. 1 for every Rs. 10,000 or part thereof (i.e. 0.01%) of the value of security at the time of its purchase/sale as the case may be. However, if the securities are not delivered, it is levied @ 20 paise for every Rs 10,000/- or part thereof (0.002%).

The depositories provide depository services to investors through depository participants. They do not charge the investors directly, but charge their DPs who are free to have their own free structure for their clients.

Trading Cycle : The trades accumulate over a trading cycle of one day and at the end of the day, these are clubbed together, and positions are netted and payment of cash and delivery of securities settle the balance after 3 working days. All trades executed on a day 'T' are settled on T+3 day.

Risk Management : To pre-empt market failures and protect investors, the regulator/exchanges have developed a comprehensive risk management system, which is constantly monitored and upgraded. It encompasses capital adequacy of members, adequate margin requirements, limits on exposure and turnover, indemnity insurance, on-line position monitoring and automatic disablement, etc. They also administer an efficient market surveillance system to curb excessive volatility, detect and prevent price manipulations. Exchanges have set up trade/ settlement guarantee funds for meeting shortages arising out of non-fulfillment/partial fulfillment of funds obligations by the members in a settlement. A clearing corporation assures the counterparty risk of each member and guarantees financial settlement in respect of trades executed on NSE.

Government Securities : Most of the secondary market trades in government securities are negotiated between participants (Banks, FIs, PDs, MFs) having SGL accounts with RBI. These may be negotiated directly between counter parties or negotiated through brokers. NDS of RBI provides an electronic platform for negotiating trades in government securities. If a broker is involved, the trade is reported to the concerned exchange. Trades are also executed on electronic platform of the WDM segment of NSE.

Negotiated Dealing System : NDS facilitates screen based negotiated dealing for secondary market transactions in government securities. NDS members concluding deals outside NDS system in government securities are required to report the deal on NDS system within 15 minutes of concluding the deal. The deals reported / negotiated on NDS, without the use of brokers, are required to be settled on T+0 or T+1. The deals executed through brokers need to be reported to exchanges and can be settled on T+0 to T+5 basis. The system is designed to maintain anonymity of buyers and sellers but only the vital information of a transaction viz., ISIN of the security, nomenclature, amount (face value), price/ rate and/or indicative yield, in case applicable, are disseminated to the market. NDS interfaces with CCIL for settlement of government securities transactions for both outright and repo trades done/ reported by NDS members.

Wholesale Debt Market of NSE : Trading system provides two market sub-types: continuous market and negotiated market. In continuous market, the buyer and seller do not know each other and they put their best buy/sell orders, which are stored in order book with price/time priority. If orders match, it results into a trade. The trades are settled directly between the participants, who take an exposure to the settlement risk attached to any unknown counter-party. A trade does not take place if both the buy/ sell participants do not invoke the counter-party exposure limit in the trading system. In the negotiated market, the trades are normally decided by the seller and the buyer outside NSE, and reported to NSE through the broker. Thus, deals negotiated or structured outside the exchange are disclosed to the market through the trading system. As buyers and sellers know each other and have agreed to trade, no counter-party exposure limit needs to be invoked. The trades, reported or executed, on the WDM segment could be either outright trades or repo transactions with flexibility for varying days of settlement (T+0 to T+5) and repo periods (1 to 14 days).

Clearing Corporation of India Limited : The CCIL facilitates settlement of transactions in government securities (both outright and repo) on Delivery *versus* Payment (DVP-II) basis which provides for settlement of securities on gross basis and settlement of funds on net basis simultaneously. It acts as a central counterparty for clearing and settlement of government securities transactions done on NDS.

Derivatives Market

Only two exchanges, namely the NSE and BSE, offer platform for trading of derivatives of securities. (Interest rate derivatives such as FRAs/IRSs are traded on OTC). In view of 99% market share by NSE, this section discusses market design of NSE. The derivatives trading system at NSE provides a fully automated screen-based trading for Nifty futures and options and stock futures and options on a nationwide basis as well as an online monitoring and surveillance mechanism. It supports an anonymous order driven market, which operates on a strict price/time priority. It provides tremendous flexibility to users in terms of kinds of orders that can be placed on the system. The contract specification for derivatives are summarised in Table 5.

REGULATORY FRAMEWORK

The four main legislations governing the securities market are: (a) the SEBI Act, 1992 which establishes SEBI to protect investors and develop and regulate securities market; (b) the Companies Act, 1956, which sets out the code of conduct for the corporate sector in relation to issue, allotment and transfer of securities, and disclosures to be made in public issues; (c) the Securities Contracts (Regulation) Act, 1956, which provides for regulation of transactions in securities through control over stock exchanges; and (d) the Depositories Act, 1996 which provides for electronic maintenance and transfer of ownership of demat securities.

Legislations

SEBI Act, 1992: The SEBI Act, 1992 establishes SEBI with statutory powers for (a) protecting the interests of investors in securities, (b) promoting the development of the securities market, and (c) regulating the securities market. Its regulatory jurisdiction extends over corporates in the issuance of capital and transfer of securities, in addition to all intermediaries and persons associated with securities market. It can conduct enquiries, audits and inspection of all concerned and adjudicate offences under the Act. It has powers to register and regulate all market intermediaries and also to penalise them in case of violations of the provisions of the Act, Rules and Regulations made there under. SEBI has full autonomy and authority to regulate and develop an orderly securities market.

Table 5

Contract Specification for F&O Contracts at NSE

Particulars	*Index Futures*	*Stock Futures*	*Index Options*	*Stock Options*
Security Description	N FUTIDX NIFTY	N FUTSTK ——	N OPTIDX NIFTY	N OPTSTK —-
Underlying	S&P CNX Nifty Index	Individual Securities	S&P CNX Nifty Index	Individual Securities
Style of Option	NA	NA	European	American
Contract Size (minimum Rs. 2 lakh)	200 or multiples thereof	Multiples of 100	200 or multiples thereof	Multiples of 100
Price Steps	Rs. 0.05			
Expiration Months	3 near months			
Trading Cycle	A maximum of three month trading cycle - the near month (one), the next month (two) and the far month (three). New contract is introduced on the next trading day following the expiry of near month contract			
Expiration Day	Last Thursday of the expiry month or the preceding trading day, if last Thursday is a trading holiday			
No. of Strike Prices	NA	NA	Minimum of 5 (two 'in the money', one 'at the money' and two 'out of the money') for every option type (i.e. call and put)	Minimum of 5 (two 'in the money', one 'at the money' and two 'out of the money') for every option type (i.e. call and put)
Strike Price Interval (in Rs.)	NA	NA	20	Between 2.5 and 100 depending on the price of underlying
Settlement	In cash on T+1 basis	In cash on T+1 basis	In cash on T+1 basis	Daily settlement on T+1 basis and final settlement on T+3 basis
Daily Settlement Price	Closing price of futures contract	Closing price of futures contract	Premium Value (net)	Premium Value (net)
Final Settlement Price	Closing value of index on expiry day	Closing value of securities on expiry day	Closing value of index on expiry day	Closing price of security on exercise day or expiry day
Settlement Day	Last trading day			
Margins	Up-front initial margin on daily basis			

NA : Not applicable.

Securities Contracts (Regulation) Act, 1956 : It provides for direct and indirect control of virtually all aspects of securities trading and the running of stock exchanges and aims to prevent undesirable transactions in securities. It gives central government/SEBI regulatory jurisdiction over (a) stock exchanges through a process of recognition and continued supervision, (b) contracts in securities, and (c) listing of securities on stock exchanges. As a condition of recognition, a stock exchange complies with prescribed conditions Central Government. Organised trading activity in securities takes place on a specified recognised stock exchange. The stock exchanges determine their own listing regulations which have to conform to the minimum listing criteria set out in the Rules.

Depositories Act, 1996 : The Depositories Act, 1996 provides for the establishment of depositories in securities with the objective of ensuring free transferability of securities with speed, accuracy and security by (a) making securities of public limited companies freely transferable subject to certain exceptions; (b) dematerialising the securities in the depository mode; and (c) providing for maintenance of ownership records in a book entry form. In order to streamline the settlement process, the Act envisages transfer of ownership of securities electronically by book entry without making the securities move from person to person. The Act has made the securities of all public limited companies freely transferable, restricting the company's right to use discretion in effecting the transfer of securities, and the transfer deed and other procedural requirements under the Companies Act have been dispensed with.

Companies Act, 1956 : It deals with issue, allotment and transfer of securities and various aspects relating to company management. It provides for standard of disclosure in public issues of capital, particularly in the fields of company management and projects, information about other listed companies under the same management, and management perception of risk factors. It also regulates underwriting, the use of premium and discounts on issues, rights and bonus issues, payment of interest and dividends, supply of annual report and other information.

RULES AND REGULATIONS

The Government have framed rules under the SCRA, SEBI Act and the Depositories Act. SEBI has framed regulations under the SEBI Act and the Depositories Act for registration and regulation of all market intermediaries, and for prevention of unfair trade practices, insider trading, etc. Under these Acts, Government and SEBI issue notifications, guidelines, and circulars which need to be complied with by market participants. The SROs like stock exchanges have also laid down their rules and regulations.

REGULATORS

The responsibility for regulating the securities market is shared by Department of Economic Affairs (DEA), Department of Company Affairs (DCA), Reserve Bank of India (RBI) and SEBI. The activities of these agencies are coordinated by a High Level Committee on Capital Markets. The orders of SEBI under the securities laws are appellable before a Securities Appellate Tribunal.

Most of the powers under the SCRA are exercisable by DEA while a few others by SEBI. The powers of the DEA under the SCRA are also concurrently exercised by SEBI. The powers in respect of the contracts for sale and purchase of securities, gold related securities, money market securities and securities derived from these securities and ready forward contracts in debt securities are exercised concurrently by RBI. The SEBI Act and the Depositories Act are mostly administered by SEBI. The rules under the securities laws are framed by government and regulations by SEBI. All these are administered by SEBI. The powers under the Companies Act relating to issue and transfer of securities and non-payment of dividend are administered by SEBI in case of listed public companies and public companies proposing to get their securities listed. The SROs ensure compliance with their own rules as well as with the rules relevant for them under the securities laws.

REGULATORY FRAMEWORK FOR CAPITAL MARKET — EMERGING ISSUES AND CHALLENGES

SONIA BAIJAL*

I. INTRODUCTION

Regulatory framework particularly in a growing market, not only govern and discipline its various constituents but also guide its development. Regulatory framework, particularly in the capital market should be such, which besides protecting the rights of investors, also encourages the development of market infrastructure, ensures efficiency, stimulates competitiveness, demands high standards of fairness from market players and above all ensures strict enforcement. Foreseeable trend in the new century is for securities laws in the developed as well as developing countries to draw closure in an evolutionary process, brought about by the twin pressures of globalisation and competition. It is, therefore, necessary that the legal and regulatory framework for securities market in India is streamlined to deal with the emerging issues and challenges.

In fact the reforms in the legal and regulatory framework, besides structural reforms in securities market, initiated so far have greatly improved resilience of capital market to withstand the pressures of globalisation and efficiency of trading and settlement mechanism.

However, continuous efforts towards its modernisation and improvement of infrastructure are required to make the market more safer, fair, efficient, competitive and attractive for the investors. In this context, a need is felt to enhance the efficiency level of corporate governance mechanism, further streamline systems and procedures for issue of capital, increase the effectiveness of monitoring and surveillance of markets. These include restructuring of the regional stock exchanges in the changing environment, setting up of a Cenralised Listing Authority, strict enforcement of regulations and most importantly, the investor protection, education and awareness.

In the following paragraphs, an attempt has been made to identify and discuss the emerging issues and challenges confronting the capital market and its regulator in India. An attempt has also been made to formulate suggestions for further reforms in securities laws and capital market.

II. DELISTING OF SECURITIES AND NEED FOR CENTRAL LISTING AUTHORITY

An important issue that has attracted countrywide debate is the delisting of securities and the need for setting up of Central Listing Authority.

Listing of securities on Indian stock exchanges is essentially governed by the provisions in the Companies Act, 1956, the Securities Contracts (Regulation) Act, 1956, the Securities Contracts (Regulation) Rules, 1957, rules, bye-laws and regulations of the concerned stock exchange, the listing agreement entered into by the issuer and the stock exchange and the circulars / guidelines issued by the Central Government and SEBI. Further, the Companies Act, 1956 requires a company intending to issue securities to public to seek permission for dealing with its securities on one or more recognised stock exchanges. The prospectus should state the names of the stock exchanges where application for listing has been made. The allotment of securities has been made void if permission for listing is not granted by all the stock exchanges before expiry of 10 weeks from the closure of the issue, providing stock exchanges a veto power to prevent an issuer from making an issue.

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The Securities Contracts (Regulation) Act has empowered the exchanges to make bye-laws providing for the listing of securities, and suspension or withdrawal of any such securities. The Securities Contracts (Regulation) Rules empowers the exchanges to grant/refuse listing and suspend or withdraw a security from listing either for a breach of or non-compliance with any of the conditions of listing or for any other reason.

Failure to comply with the requirements of Securities Contracts Regulation Act, bye laws of stock exchanges and listing agreement invites suspension of trading of the security for a specified period, or withdrawal / delisting, in addition to penalty prescribed in the Securities Contracts (Regulation) Act. The Securities and Exchange Board of India (SEBI) has permited voluntary delisting of securities from non-regional stock exchanges after providing an exit opportunity to holders of securities in the region where the concerned exchange is located. Thus a security can not be delisted from a regional exchange. An Exchange can, however, delist the securities compulsorily following a very stringent procedure.

Committee on Delisting of Shares

SEBI with a view to review the exiting delisting requirements and the listing conditions, set up a Committee under the convenorship of Shri Pratip Kar, Executive Director, SEBI. to examine and review the present conditions for the delisting of securities of companies listed on the recognised stock exchanges including the delisting by MNCs and suggest norms and procedures in connection therewith; to review and standardise the listing agreement; to examine the concept of listing at regional stock exchange and the establishment of a listing authority across the stock exchanges; to suggest ways for effective implementation of listing conditions and penal provisions for non-compliance; and to recommend changes in laws, rules regulations etc. in order to give effect to the recommendations on the above mentioned matter.

The Committee has since submitted its report. The Committee recommended that no prohibition per se should be imposed against delisting of securities provided that the securities of company have been listed for a minimum period of 3 years on any stock exchange. There should not be any selective restriction or discrimination against any class of companies for delisting. However, the regulatory framework may need to be strengthened to prevent any misuse by the companies and to ensure that investors' interests are protected at all times. The Committee further recommended that any acquisition of shares or scheme or arrangement, which may result in delisting of securities should be in compliance with the relevant provisions under SEBI regulation, circular or guideline and the provisions of the Listing Agreement.

The Committee emphasised that no company should be allowed to use the buy-back provision to delist the company and the exit price for delisting should be in accordance with the book building process.

There should be comprehensive provisions including procedures governing the entire subject of delisting of securities of companies. The provisions should also cover cases in which companies on their own seek delisting of their securities from all or some of the stock exchanges, as well as those where the stock exchanges can compulsorily delist the securities of a company. A company which is listed on any stock exchange may be allowed to delist from that stock exchange without an exit offer being made to its shareholders provided that the securities of the company are listed on BSE or NSE which have nationwide reach and in all other cases, viz. when a company which is listed on any stock exchange or stock exchanges other than BSE or NSE seeks delisting, an exit offer must be made to the shareholders in accordance with the recommendation of the Committee.

Any compulsion for the existing companies to remain listed on any stock exchange merely because it is a regional stock exchange should be done away with and companies should have the freedom to list on a stock exchange of its choice. The Committee recommended that stock exchanges should be empowered to delist those companies which have been suspended for a minimum period of six months for non-compliance with the Listing Agreement.

The Committee has also recommended the amendment in the Companies Act, 1956 allowing the stock exchanges to make an application for winding up of the company. The Committee, however, felt that such petitions against companies should be filed by the stock exchanges only on the basis of investor complaint.

In respect of setting up of a separate Listing Authority, the Committee recommended the formation of Central Listing Authority (CLA) to bring about the uniformity in the exercise of due diligence in scrutinizing listing applications. The Committee recommended that the initial role of the proposed authority may be confined to scrutinizing listing agreement and reviewing the provisions of Listing Agreement from time to time. The Committee has also recommended that Central Listing Authority should be suitably empowered by SEBI.

The Committee also favoured the reinstatement of delisted securities by the stock exchanges with a cooling period of 2 years on the basis of respective norms/criteria for listing at the time of making the application for listing and the application will be initially scrutinized by the CLA.

In the backdrop of ongoing debate and the recommendations of the Committee, it may be pointed out that there are companies whose shares are not traded at all and also a large number of loss making companies which are not making payments of the listing fees for years together and also not complying with listing requirements. There should be one time simplified mechanism for delisting of shares of these companies. Two years back, Department of Company Affairs had started schemes for clearance of pending requirements. There is also a need to introduce similar scheme for those listed companies where there is no public interest involved.

The Committee has, however, not addressed the problems of investors of small and medium cap companies which are listed only on regional exchanges. With the closure of various Regional Stock Exchanges, the shares of these companies would not be traded at all as they would neither be listed on NSE/BSE nor at any other stock exchange. To address the problems of these companies, OTCEI should be treated at par with NSE/BSE as a Stock Exchange with nationwide reach.Accordingly, a company listed on OTCEI can get its shares delisted from other exchanges without giving any exit offer as is allowed in case of companies listed on NSE/BSE.

As the procedure for reverse book building is impractical and open for manipulations, there should be minimum offer price as the average of weekly high and low of 52 weeks in case of liquid shares. Also, some transparent formula based on book value, earning per share etc. should also be worked out for illiquid shares.

The Report of the Committee provides for approval of the Central Listing Authority for listing of fresh securities. It is suggested that Central Listing Authority should also be charged with approvals of right issues, public debt issues, public equity issues by listed companies and also preferential issues, sweat equity, swaps, private placement of equities and bonus issues. It should also be entrusted with the powers of granting approval to already listed companies seeking listing at other exchanges, including suspension, delisting through takeover code and voluntary delisting. It is desirable that scope of CLA should include vetting of prospectus/letter of offer as well as monitoring and compliance of Listing Agreement as an initial role.

III. CENTRAL LISTING AUTHORITY – PROPOSED STRUCTURE AND FUNCTIONS

As recommended by the SEBI Committee on Delisting of Securities also, in the present circumstances, the idea of Central Listing Authority is definitely laudable. The CLA can be a useful tool for avoiding duplication of regulatory filings, monitoring compliances and information dissemination and would definitely go a long way in smoothening the system and restoring investor confidence.

At present, there are about 10,000 companies listed on Indian exchanges. Assuming that each company is listed on an average of three exchanges, which means that there are at least 30,000 compliances and monitoring to be done. It is just a waste of resources because the terms are not uniform across the exchanges. These wastages can be avoided if the issuer of securities are asked to comply with a standard set of requirements, so that duplication/ triplication of efforts in terms of processing, agreement, compliance and monitoring could be avoided. It is desirable that there is only one agency which considers all requests for listing and grants listing, if it finds a security suitable for investors across the country. A security granted listing by the agency should be available for trading on all exchanges. It will reduce the waste of resources in terms of duplication of efforts on listing and monitoring compliance. The security should also be monitored, and suspended and withdrawn from centralised trading by the listing agency. The investors and market participants should get all the company related information, which are mandatorily required to be filed by companies, at one central location preferably on web site maintained by the Central Listing Authority.

Centralised Listing Authority should be an independent authority not dependent on listing income for survival.

As stated earlier also CLA should be charged with approvals of IPOs, right issues, public debt issues, public equity issues by listed companies and also preferential issues, private placement of equities and bonus issues. It should also be entrusted with the powers of granting approval to already listed companies seeking listing at other exchanges, including suspension, delisting through takeover code and voluntary delisting. 'CLA' should be charged with the responsibility of developing a standard listing agreement applicable to all the exchanges and its updation on continuing basis; monitoring of the compliance of the listing agreement by all listed companies. CLA should develop a website where it should not only provide complete information on listing norms and guidelines but also daily company wise compliance/non-compliance status report. This would not only help the investors but also put to public exposure the non-complying companies. All companies should be required to file balance sheets, financial results and other mandatory information electronically with CLA which in turn should make it instantly accessible to everyone. CLA should, therefore, become single source of information for all listed companies. CLA should also be entrusted with the job of the forum for redressal of grievances of the investor. It should also have a recommendatory role in terms of development of new policies which are required for the capital market. CLA should be empowered to ask for information, levy penalties and take other suitable actions.

CLA should be set up under direct control and supervision of SEBI. It should be headed by a full time or part time Governor to be assisted by a board comprising of representative from SEBI, Government, stock exchanges, investor association, professional bodies such as ICSI, ICAI, analysts and media. The board should be accountable and responsible to the chairman of SEBI. CLA should be assisted by a full team of professionals who would be drawn from securities industry. It should have its own office and not dependent upon one of the exchanges for support. The moment CLA is dependent on the fee from issuers, it may not be able to really delink itself and take appropriate actions and proper monitoring. The agency should be an absolutely independent agency, single agency. The role of stock exchange has to be very well defined. Stock exchanges should provide the forum for trading, settlement mechanism and address the investor grievances.

CLA should emphasize on the importance of disclosure of intermediation, as transparency of information at market place promotes market discipline which in turn maintain standard of conduct. Central authority should provide incentives to issuer companies to maintain standards and seek continuous improvement in practice. It should also take full advantage of technology to improve efficiency.

IV. CORPORATISATION AND DEMUTUALISATION OF STOCK EXCHANGES

The Finance Minister in his budget speech for 2002-03 emphasized that process of Corporatisation and demutualisation would be completed during the course of the year to implement the decision to separate ownership, management and operation of the stock exchanges. Since these are complex issues, SEBI constituted a Group under the chairmanship of Justice M H Kania, former Chief Justice of India to review and examine the present structure of stock exchanges including those set up as companies and as unincorporated bodies and in this light examine the legal, financial and fiscal issues involved to corporatise and demutualise the stock exchanges; to recommend the specific steps that need to be taken for implementation; and to advise on the consolidation and merger of stock exchanges.

The major recommendations of the Group include a uniform model for corporatisation and demutualisation to be adopted by all the stock exchanges, and submission of a scheme of demutualisation to SEBI by an appointed date and non-compliance to result in lapse of recognition granted to an existing stock exchange, whether permanent or temporary, merger of stock exchanges before or after demutualisation to be a commercial decision and the choice to be left to the concerned stock exchanges. However, the corporatisation and demutualisation should facilitate the process of consolidation of stock exchanges.

The Committee opined that as corporatisation and demutualisation of a stock exchange is essentially a conversion from a not for profit entity to a for-profit company, and would result in a distribution of assets, the Income Tax Act should be amended, if necessary, so that the past profits of an stock exchange which were not taxed when it had the character of a not for profit entity should not be taxed when its character changes. It was of the view that necessary provisions should also be made in the Indian Stamp Act and the Sales Tax Laws to exempt from stamp duty and sales tax, the transfer of the assets from the mutual stock exchange and the issurance of shares by the new demutualised for-profit company, formed pursuant to an approved shceme of demutualisation.

The Committee also recommended that the three stakeholders viz. shareholders, brokers and investing public through the regulatory body should be equally represented on the governing board of the demutualised exchange. There should be specific vacancies on the board for each group of stakeholders and the shareholders' representatives should not be functioning brokers. Also, the brokers representatives should be elected by the shareholders from among the brokers of the exchange.

The Committee recommended that the representatives of the investing public would be nominated by SEBI from among a panel comprising of academics, professionals, industry representatives, public figures and investor associations, none of whom should have any interest in any broking firm. There should be adequate disclosures about the background of the directors of the board to the shareholders at the annual general meetings and the annual reports and the maximum number of directors on the board would be governed by the relevant provisions of the Companies Act, 1956 and current restrictions on the tenure of broker directors should continue.

The exchange must appoint a CEO who shall be responsible for the day to day functioning of the exchange. The CEO would be solely responsible for the day to day functioning of the exchange which would also include compliance with various regulations and risk management practices. The Committee recommended that it would be optional for the exchange to appoint a CFO in addition to the CEO and the board should not constitute any committee whose effect would be to dilute the independence of the CEO of the exchange and the day to day functioning of the exchange.

The Committee did not prescribe any specific form of dispersal but there should be a time limit prescribed, say three years which can be extended by a further maximum period of 2 years with the approval of SEBI, within which at least 51% of the shares would be held by non-trading members of the stock exchange. The Committee recommended that the demutualised exchanges should list its shares on itself or on any other exchange. However, this may not be made mandatory; in case the exchange is listed, the monitoring of its listing conditions should be left to the Central Listing Authority or SEBI following the pattern obtained in UK and Australia where the market regulators viz. FSA and ASIC supervise the listing.

In the backdrop of preceeding discussions and recommendations of the Committee, it may be observed that the merger of stock exchanges on the lines of Euronext as recommended by the Committee would definitely lead to utilisation of existing infrastructure facility of stock exchanges and would also address the problems of small and medium cap companies. It is, however, suggested that instead of giving an option in the hands of stock exchanges, regional exchanges must be combined compulsorily on the lines of Euronext. It is also suggested that all small and medium cap companies with some prescribed paid-up capital limit should exclusively trade on the stock exchange formed on the lines of Euronext. NSE/BSE should concentrate only on the shares, which are not traded on the exchange formed on the basis of Euronext.

Finding a suitable exit route for members as recommended by the Committee is definitely required. There should not be distribution of assets of the stock exchange. It is also suggested that some Special Purpose Vehicle should be developed to whom pre demutualisation holding or existing shareholdings should be transferred. After demutualisation, the Special Purpose Vehicle can distribute shares to such entities as may be decided including to public for listing but all the shareholders should be non-trading members only. There is no question of recoupment of the investments made by the members in the stock exchanges. The members have only acquired shares by making its payment. The assets of the stock exchanges including reserves have been created mainly out of the listing fees and interest on investment of surplus funds from companies prescribed by Ministry Finance/SEBI and not out of any contribution made by the shareholders which too, if any, is insignificant.

V. INSIDER TRADING

It is undisputedly argued that unrestricted insider trading leads to a breakdown of those capital markets, which are unable to perform their role efficiently. The primary argument against insider trading is that it works to the disadvantage of outside investors who would then exit the marketplace, taking their capital with them. The argument in favour of allowing insider trading is that such trading leads to more informative security prices. The least restrictive view of insider trading sees it as illegitimate only if it involves a breach of fiduciary duty or a breach of trust and confidence. Thus, the profits that is made at the expense of shareholders is an abuse of the confidence and trust reposed in the company by its shareholders.

"Insider trading" is a vague term, which is subject to many definitions and connotations encompassing both legal and prohibited activities. Insider trading occurs when a person who possesses material non-public information trades in securities on the basis of such information or communicates such information to others who trade.

The person who trades or "tips" information violates the law, if he has a fiduciary duty or other relationship of trust and confidence not to use such information.

The Securities and Exchange Board of India framed SEBI (Insider Trading) Regulations in 1992 to tackle insider trading. The objective of the regulations is to prevent insider trading by prohibiting dealing, communicating or counselling on matters relating to insider trading.

SEBI Regulations, 1992 defines the "Insider" as any person who is or was connected with the company or is deemed to have been connected with the company, and who is reasonably expected to have access, by virtue of such connection, to unpublished price sensitive information in respect of securities of the company, or who has received or has had access to such unpublished price sensitive information.

As per SEBI Regulations, 'Insider Trading' is the buying or selling or dealing in the securities of a listed company by a director, member of management, an employee of the firm or by any other person such as internal and statutory auditor, agent, advisor, analyst, consultant etc. who has knowledge of material, `inside' information not available to the general public. The dealing in securities by an 'insider' is illegal when it is predicated upon the utilization of `inside' information to profit at the expense of other investors who do not have access to the same information. The prices of most securities reflect the available public information about those companies. Hence, any investor who acts on non-public information does so at the cost of public confidence in the securities market and in the process he corrupts the `level playing field'.

'Price Sensitive Information' as defined in the Regulations means any information which relates directly or indirectly to a company and which if published is likely to materially affect the price of securities of a company. As per the regulations, the following are deemed to be price sensitive information:

(i) periodical financial results of the company
(ii) intended declaration of dividends (both interim and final)
(iii) issue of securities or buy-back of securities
(iv) any major expansion plans or execution of new projects
(v) amalgamation, mergers or takeovers
(vi) disposal of the whole or substantial part of the undertaking
(vii) any significant changes in policies, plans or operations of the company.

Trading Restrictions for Insiders

The regulation provides that every listed company shall specify, a trading period, to be a Trading Window for dealing in the securities of the company. The trading window shall be closed during the time any price sensitive information remains unpublished.

All directors/officers/designated employees of the company shall conduct all their dealings in the securities of the company only in a valid trading window and shall not deal in any transaction involving the purchase or sale of the company's securities during the period when trading window is closed.

Disclosure Norms

SEBI has also put in place the disclosure norms for the office bearers of the stock exchange and directors of Asset Management Companies (AMCs) to prevent Insider Trading. The directors of AMCs are required to file the details of the purchases and sales of transactions on quarterly basis.

Penalty/Punishment

Any director/officer/designated employee of the company and any other person considered as an insider who deals in securities or communicates any price sensitive information, in violation/ contravention of a listed company's internal code may be penalized by the company. The company may take appropriate action against such person which may include disciplinary action viz. wage freeze, suspension, ineligibility for future participation in employee stock option plans, etc.

Such a person shall also be subject to any action that may be taken by SEBI for violation of the code as per Section 15G of the SEBI Act.

Under Section 24 of SEBI Act, any one who contravenes the Regulations is punishable with imprisonment for a maximum period of one year or with fine or with both.

Apart from the above, to protect the interests of investors and in the interests of the securities market and for due compliance with the provisions of SEBI Act and the Regulations made thereunder, SEBI may issue orders prohibiting the insider or restraining the insider from dealing in the securities of listed companies. SEBI may issue orders declaring such transactions in securities as null and void. Further SEBI may issue directions to the persons who acquired the securities in violation of the Regulations to deliver the securities back to the seller or to transfer proceeds equivalent to the cost price or market price of securities whichever is higher to the investor protection fund of a Recognised Stock Exchange. Recently, the Insider Trading Regulations have been amended to empower SEBI to appoint investigating authority to investigate and inspect books of account, other records and documents of an insider.

Intimation to SEBI

Any violation of the Regulations observed by the company/compliance officer shall be intimated to SEBI by the company.

Thus, Insider Trading not only cause wide fluctuations in the price of securities but also undermines the trust of investors in the capital market. When investors find that the stock markets are rigged, they simply shy away from the market. Consequently, the corporate sector cannot mobilize the savings of small investors and the economy is deprived of the investments so badly required for trade and industry.

Insider trading is an extraordinarily difficult offence to prove. The underlying act of buying or selling securities is, of course, perfectly legal activity. It is only the intention of the trader that can make this legal activity a prohibited act of Insider trading.

In the whole panoply of growing instances of insider trading and subsequent proportionate regulatory developments it is felt necessary that SEBI gives a re-look to the issue of Insider trading. As far as SEBI's ability to implement these guidelines is concerned, "Enforcement is the key to success of the regulation."

VI. SEBI TAKEOVER CODE

Till the early nineties, the Indian economy functioned in an environment regimented by control and regulations. With the reforms initiated by the Government, the economy moved from controlled to market driven. The forces of globalisation and liberalisation compelled the corporates to restructure the business by adopting the tools, viz, mergers, amalgamations and takeovers. All these activities, in turn, impacted the functioning of the capital market, more particularly the movement of share prices. As the shares of companies are held by different segments of society, viz., entrepreneurs, institutional investors and individual shareholders including small investors, it is reasonable that there should be equality of treatment and opportunities to all shareholders, transparency, proper disclosure and above all protection of interests of small and minority shareholders. In order to ensure observance of these basic principles in takeover of companies, right from 1994 Takeover Regulations were introduced and amended from time to time to meet the fast changing market realities.

The regulations, as amended by the Second Amendment Regulations, 2002, seek to provide a more broad based and effective framework for takeovers in the light of the experience gained as a result of enforcement of the regulations since 1994.

A study of SEBI has worked out the impact of Takeover Regulations. The study revealed that over the last couple of years, there has been a substantial increase in takeovers. Since SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 1997 came into existence, 1,011 companies have been taken over for various purposes, which include, consolidation of holdings, change in control of management and substantial acquisition. The most important objective has been change in control of management and accounted for 61% of cases of takeovers. The number and value of takeovers has increased sharply as corporates became better aware of the regulations and their utility in successful restructuring.

There are clear industry concentrations. While finance and information technology industries score very high on the number of companies acquired, on the basis of amount spent, the electronic/electrical industry occupies number one position followed by metal and cement and construction. Further, mostly Indian companies/promoters are the major users of acquisition mechanism. Foreign companies/ promoters accounted for only 15% of all takeovers. The study has estimated that through the Takeover Regulations the investor has benefited to the extent of Rs.42.5 billion.

Offer period has been defined as to mean the period between the date of entering into Memorandum of Understanding or the public announcement and the date of completion of offer formalities relating to the offer made instead of the period between the date of public announcement of the first offer and the date of closure of that offer.

The term Promoter includes the person or persons who are in control of the company directly or indirectly, whether as a shareholder, director or otherwise and person/persons named as promoters in any document of offer of securities to the public or existing shareholders and includes a relative of the promoter, any firm or company, directly or indirectly, controlled by the promoter or relative of the promoter or a firm or HUF in which the promoter or his relative is a partner or copartner or a combination thereof.

If the promoter is a body corporate, promoter include a subsidiary or holding company, any firm or company, directly/indirectly, controlled by the promoter of that body corporate or his relative or a firm or HUF in which the promoter or his relative is a partner or co-partner or combination thereof. It has also been provided that the share of the promoter or his relative in the firm should not be less than 50% in case of partnership firm.

The amendment has made SEBI Regulations applicable to the acquisition of shares in the ordinary course of business by the International Finance Corporation, Asian Development Bank, International Bank for Reconstruction and Development, Commonwealth Development Corporation and such other International Financial Institution, a merchant banker or promoter of the target company pursuant to a scheme of safety net under SEBI (Disclosure & Investor Protection) Guidelines, 2000 in excess of limits specified in the Regulations.

The Regulations have also been made applicable to the acquisition of shares by a person in exchange of shares received under a public offer made under the takeover regulations.

The newly substituted provision regarding offer price states that the offer to acquire shares under SEBI Regulations shall be made at a price not lower than the price determined as per sub regulations 20(4) & 20(5). The offer price shall be payable in cash; by issue or exchange and or transfer of shares (other than preference shares) of acquirer company, if the person seeking to acquire the shares is a listed body corporate or by issue, exchange and, or transfer of secured instruments of acquirer company with a minimum A grade rating from a credit rating agency registered with the Board.

In case the payment has been made in cash to any class of shareholders for acquiring shares under any agreement or pursuant to any acquisition in the open market or any other manner during the immediately preceeding twelve months from the date of public announcement, the letter of offer should give an option to the shareholders to accept payment either in cash or by exchange of shares or other secured instrument.

The new provision allows the alternation of mode of payment in the case of revision of offer price or size, subject however to the condition that the amount to be paid in cash as mentioned in any announcement or the letter of offer is not reduced.

Additionally, in case the offer price consists of payment of consideration in securities, the acquirer is required to obtain the approval of shareholders within twenty one days from the date of closure of the offer. The acquirer has been put under obligation to pay entire consideration in cash, if he fails to obtain the requisite approval.

Explanation to new Regulation clarifies that in the case of disinvestment of a Public Sector Undertaking, the relevant date for the calculation of the average of the weekly or daily high and low of the closing prices of the shares of the Public Sector Undertaking, as quoted on the stock exchange where its shares are most frequently traded, shall be the date preceding the date when the Central

Government or the State Government opens the financial bid.

The regulation 20A states that an acquirer who has made a public offer and seeks to acquire further shares under sub regulation (1) of regulation 11 shall not acquire such shares during the period of 6 months from the date of closure of the public offer at a price higher than the offer price.

Regulation 21A allows an acquirer or any person acting in concert with him to make an offer conditional as to the level of acceptance which may be less than twenty per cent. However, where the public offer is in pursuance of a Memorandum of Understanding, the Memorandum of Understanding should contain a condition to the effect that in case the desired level of acceptance is not received the acquirer shall not acquire any shares under the Memorandum of Understanding and shall rescind the offer.

Amnesty Scheme

On similar lines as the Company Law Settlement Scheme announced by the Department of Company Affairs, SEBI has introduced a SEBI Regularisation Scheme, 2002 to enable the companies and persons, who have not complied with the disclosure requirements under the Takeover Regulations, 1997, or who have made disclosures after expiry of the period specified in the Regulations, to avail one time opportunity and regularise non compliance of the Regulations.

The person/company may make disclosures and pay the specified lump sum amount. For individuals, the Scheme is valid from 1st October, 2002 to 31st December, 2002 and for companies, the scheme will be in force from 1st October, 2002 to January 31, 2003.

The amnesty scheme announced by SEBI i.e. SEBI Regulation Scheme, 2000 for companies and persons who have violated the provisions of Takeover Code by not providing adequate disclosures is a welcome measure to the extent that the time and cost involved improving a charge is not commensurate with the offence. However, case must be taken that such amnesty scheme does not become a regular feature. This may otherwise encourage companies to take the easy way of violating the guidelines and then seeking refuge under the amnesty scheme by paying a small sum by way of fine.

The Takeover Code may also address the issue of whether the acquisitions which go against the Takeover Regulations should be declared void. At present, the Code is silent on this issue and may lead to avoidable practical problems.

The amendment in the regulations regarding removal of exemption to preferential allotment is in the interest of minority shareholders. However, a number of questions are also being raised in terms of its implication on the investment plans of foreign private equity players or other strategic investors who often use this route to acquire strategic stake in a company. The amendment would mandate the foreign investors to offer exit option to the investors who are otherwise unwilling to continue to hold stake in the company. The substantial increase in the cost of investment may discourage such strategic investors from taking stake in listed companies.

The definition of control under the regulations continues to be ambiguous and needs to be simplified for a more effective implementation of the Code.

With a view to prevent cases of asset stripping, the amended Takeover Code has provided that acquirer shall not sell or dispose of any substantial asset of the target company except with prior approval of the shareholders. However, it should also be clarified as to upto what time frame the sale or disposition would not be permitted.

VII. SECURITIES AND EXCHANGE BOARD OF INDIA (AMENDMENT) ORDINANCE, 2002

The ordinance to amend the SEBI Act has been promulgated on October 29, 2002, empowering SEBI with enough teeth to take on manipulators and market players violating its regulations. The amendments to SEBI Act would enable the market regulator to enjoy additional powers on search and seizure and penalty imposition.

The ordinance empowers the regulator by hiking the monetary penalties for various offences to either three times the undue gains made by a market player or a maximum of Rs. 25 crore. SEBI has also been empowered to search and seize books of accounts and other documents of stockbrokers and intermediaries, after obtaining the approval of a magistrate. It can also call for information from banks and financial institutions.

The Ordinance also sought to make SEBI more of a board driven institution. The SEBI board will now be strengthened, taking the total number of members to nine. Of this, three are required to be full time members, excluding the Chairman.

Securities Appellate Tribunal (SAT), which is now a single member tribunal, has been made a three member body. The Presiding Officer of SAT will now be a serving or retired judge of the Supreme Court or serving or retired Chief Justice of a High Court. The Ordinance has empowered SAT and courts to compound offences. Also, appeals against SAT orders can now be taken up before the Supreme Court only on points of law.

Although, the SEBI regulations clearly set out the definitions of offences, the Ordinance defines offences like insider trading, fraudulent and manipulative trade practices and market manipulation. All these changes would address the problems faced by SEBI recently in tackling the misconduct of market players.

VIII. INVESTOR EDUCATION AND AWARENESS

Investors are the backbone of the securities market. It is the investor education and awareness that holds the key to reviving the interests of the investors in the securities market and to infuse confidence in them. Many of them do not possess adequate expertise/knowledge to take informed investment decisions. They are generally not aware of the complete risk-profile of the companies they are investing their money in. The regulators, SROs, non-government organisations (NGOs), and investor associations need to educate them.

Realising its importance, SEBI has launched an intensive investor education exercise aimed at protecting the interests of investors in securities market. It helps the investors in redressal of complaints regarding securities investments. It also disseminates through its website and press briefings the policy developments and enforcement actions for the information of investing community. It has published a number of booklets on policy and market developments for educating the investors.

Recently, the Department of Company Affairs (DCA) informed the general public about the agency they should approach for redressal of their grievances. The investor complaints relating to deposits in banking companies and non-banking financial companies are dealt with by RBI, the complaints relating to non-banking non-financial companies (listed) are dealt with by SEBI and the complaints in respect of non-banking non financial companies, the depositors should approach the Company Law Board and if the orders passed by the Board are not honoured then they should approach the concerned Registrar of Companies with a certified copy of the order. Investor complaints of unlisted companies are dealt with by DCA. These complaints relate to non-registration of transfer of shares, non-refund of share application money, non-receipt of dividends, non-receipt of duplicate shares, non-issue of share certificates, non-issue of debenture certificates, bonus shares, share certificates on conversion, after endorsement etc. The complaint is pursued with the company by DCA and in case of non-settlement of the complaint; the matter is referred to the Registrar of Companies for prosecution.

DCA, SEBI and Exchanges have set up investor grievance cells for redressal of investor grievances. The exchanges maintain investor protection funds to take care of investor claims, which may arise out of non-settlement of obligations by a trading member for trades executed on the exchange. DCA has also set up an investor education and protection fund for the promotion of investors' awareness and protection of interest of investors.

Despite the herculian efforts undertaken by the government, SEBI, Stock Exchanges and others as regulatory organisations, the investor awareness in India remains extremely low. Only a fraction of the investors actually derive advantage of the plethora of information revealed through the medium of prospectus, offer documents and annual reports. The reason is the lack of investor education.

There is an need to evolve securities law in a manner that the information given by the corporate to the investors is in a simple and easily understandable language avoiding legal jargon and financial terms. Even the Balance Sheet and Profit and Loss details could be better explained in a simple language to a lay investor.

It is therefore imperative on the part of the SEBI, RBI, DCA and all constituents of the capital market to make concerted efforts to educte the investors and to create awareness among them so that they are able to make considered investment decisions.

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MULTILATERAL AGREEMENT ON INVESTMENT (MAI) UNDER WTO : POLICY IMPERATIVES FOR DEVELOPING ECONOMIES

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INTRODUCTION

The establishment of World Trade Organisation (WTO) marks a watershed in the international economic and trade relationships. The ambit and jurisdiction of WTO is widening and becoming a virtual forum for perpetual negotiations on newer and newer issues. At the third Ministerial Conference of WTO held at Seattle in November – December, 1999 the industrialised countries tried to push comprehensive agenda for trade negotiations including reduction of industrial tariffs, further liberalization of agricultural trade, multilateral framework of rules on investment, agreement on governments procurement, electronic commerce and improvement in existing WTO agreements from their perspective.

But the ministerial meeting in Seattle turned out to be fiasco. Domestic policies in the United States played a key role in the failure to attain consensus on a broad negotiating agenda, greatly reducing the willingness of the United States administration to agree to put items on table that were opposed by domestic lobbies. Strong differences on the scope of agricultural liberalization between the European Union, on the one hand, and the United States and other agricultural exporters, on the other hand, were also important. Another major factor was the active and full-fledged participation by developing countries, many of which refused to accept the agenda being pushed by a number of high-income countries in some areas most notably the United States on labour standards and raised concern about implementation problems associated with the Uruguay Round. Many also expressed general dissatisfaction concerning the process through which a negotiating agenda was being set. Small countries in particular perceived themselves to be left out completely, not having access to the forum where potential agenda – setting compromises were being crafted.

In the two years following the Seattle ministerial meeting, a great deal of efforts at the WTO was focused on dealing with implementation concerns of developing countries and on building the confidence of the smaller and poorer members in the trading system. Many of the implementation concerns deals with trade and development issues. An important part of confidence-building agenda has been proposals for high income countries to grant unrestricted market access to the least developed countries.

The Doha Development Agenda that emerged from the 2001 WTO ministerial meeting in Doha, Qatar, launched a broader set of negotiations. The Doha agenda gives great prominence to development concerns, reflecting proactive participation by developing countries in the process. Negotiations are to take place on market access for manufacturer, disputes settlement, WTO rules, disciplines on regional integration, environment and trade related Intellectual Property Rights (TRIPs)(geographical indications). These negotiations will complement the ongoing negotiations on agriculture and services mandated by the Uruguay Round Agreement. Negotiations may be launched on the four issues—trade facilitation, transparency in government procurement, competition policy, and investment policy — at the 2003 WTO ministerial meeting if consensus exists on the modalities of such talks. The Doha agenda explicitly deals with key concerns of developing countries, including implementation issues from Uruguay Round, the need for technical

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cooperation and capacity building in developing countries, and the market access for the least developed countries. The meeting also dealt with concerns of developing countries about intellectual property rights and public health.

Two developments have paved the way for industrialised countries pushing their demand for an Multilateral Agreement on Investment (MAI), the decision taken at Singapore Ministerial Conference of WTO in December 1996, and OECD negotiation on MAI launched in September 1995.

GLOBALISATION

Globalisation means integration of economies, societies, through the cross-country flows of information, ideas, activities technologies, goods, services, capital and people. The world economy at large has been witnessing an increase in globalization of national economies brought about by a revolution in communication technology and increased liberalization. This is manifest in trade, finance, the application of technology and the location of production.

As globalization integrates markets in goods, services, capital technology and labour, it can bring new instability including interest and exchange rate fluctuation and volatile short-term capital flows. It can therefore increase the vulnerability of developing countries. But it also generates many potential benefits and creates new avenues for international co-operation. This dialectic compels developing countries to try to mitigate the negatives and capitalise on positives of the process by sharing experience and learning from one another achievement and difficulties.

While globalization was manifest in 19th century, at that time it was limited to cross-border flow of goods, capital and people with in few dominant economies. By contrast, recent trends in globalization are more wide spread and involve participants. Moreover, 19th Century globalization did not have inter governmentally approved legal rules, norms and institutions as contemporary globalization does.

The broad scope of contemporary globalization places developing countries and their enterprises within its reach. Developing countries have a genuine interest to avoid being marginalised vis-à-vis major participants in the emerging global order. The benefits countries could gain from globalization depend on how strongly they can participate i.e. their economic and institutional capacity. By virtue of their low level of development, developing countries would, thus not be among the important beneficiaries. To change this negative scenario and to secure level playing field for themselves and to build the required competitive and institutional capacities for their enterprises there is immense need for co-operation among developing countries.

Besides, developing countries seem motivated to form and consolidate viable economic spaces which would stimulate dynamic growth in trade investment and productive capacity. Within such spaces, it is easier to develop viable integrated and competitive productive systems and to secure strong market bases and marketing experience. From these foundations, enterprise can better launch into the global market with the requisite competitive wherewithal.

REGIONAL ECONOMIC COOPERATION

The impetus behind increased regionalism is aided by several related trends. It is encouraged by wide ranging policies of national economic reforms, especially those favouring free markets. This market emphasis leads naturally to more co-operative agreements being reached at sub-regional and regional levels and to the adoption of liberal international policies vis-à-vis the rest of the world. There is growing convergence in the main macro economic policies of various countries. This, in turn widens the scope for developing and strengthening interstate economic and political linkages. Finally, significant impetus for trade liberalization comes from international level. This arises with the conclusion of Urguay Round Multilateral Trade Negotiations and creation of World Trade Organisation, which came into being on 1 January 1995.

IMPLICATIONS OF WTO

The newly emerging international trading framework has implications for trade-related co-operation among developing countries at national, bilateral, sub-regional and inter-regional level. Existing policy instruments from the General Agreements on Tariffs and Trade (GATT) still affect this Co-operation. In addition, new policy instruments resulting from the Urguay Round at the establishment of WTO are having effects and will undoubtedly have more in the future.

Among the newly arising issues, perhaps the most critical are the following :

— Free trade areas and customs unions are being more closely disciplined. They are expected to achieve their goals within a 10 year time limit. Provisions for their common external tariffs are tightened. The mechanism for dispute settlement is now applied to them. These disciplines are stronger than under GATT (Article XXIV). At the same time, there are special provisions favouring developing countries in the WTO agreement (Part IV), and post-GATT decisions regarding preferences remain in force (such as the "enabling clause").

— The multilateral trading framework has been extended to cover the growing services sector. The General Agreement on Trade in Services (GATS) contains provisions (in Article V) regarding the integration of groupings similar to those in GATT (Article XXIV).

— Regional trade agreements are to be examined more closely. The aim is to ensure they conform to WTO agreements and to trace their implications for regional multilateral trading systems.

— Specific limits have been placed on Governments' use of promotional instruments to expand foreign trade, investments and services.

— Provisions regarding the duration of GATT waivers have been substantially tightened.

The interplay between the global disciplines and the provisions of sub-regional, regional and interregional agreements is also shifting in at least following four ways :

First, some disciplines which were created through agreements at lower geographic levels have become globalised and extended to all members of WTO.

Second, in some cases, global requirements which are more stringent than those in smaller cooperation groups eventually overtake them. Also, "new" issues on the global agenda get incorporated into regional agreements.

Third, WTO global standards increasingly form a base, which is built upon, refined, technically perfected and intensified at the sub-regional, regional and inter-regional level. The resulting trade, investment and financial agreements among groups of countries can be referred to as "WTO plus regionalism".

Fourth, there may be a danger that partners to a regional agreement will negotiate disciplines and adopt approaches in the regional context that could be inconsistent with the practice in other regions and with an eventual global agreement on such issues.

The challenge facing developing countries is to organise their cooperation so as to maximise its benefits and concurrently contribute to the proper functioning of international trading and financing systems. The interaction of regionalism with international disciplines is a new phenomenon and calls for a revision of traditional notions of economics. The contents of the new modes of cooperation, and indeed of all ECDC activities under the prevailing conditions of the globalizing world economy, are interactive and compatible with globalization.

MULTILATERAL AGREEMENT ON INVESTMENT (MAI)

Some developed countries, led by the European Union (EU), are attempting to introduce a Multilateral Investment Agreement (MIA) at WTO. At another level, it is being negotiated by the OECD member countries, which OECD later plans to open for other countries to join. The acronyms shift from MIA to MAI, but the two models are basically the same.

SALIENT FEATURES OF MAI

The MAI aims to protect and advance the rights of international investors vis-à-vis host governments and countries. The main elements are :

— The right of entry and establishment of foreign companies to enter and establish themselves in almost all sectors of a country, except security. This means that a government will lose its authority to determine which foreign investor it would allow or disallow from entering the country.

— The right to full equity ownership. This means that a government would not be allowed to require foreign companies to allow a portion of their equity to be locally owned, or form joint ventures with local firms or the state.

— National treatment - This means that a foreign company would have to be treated equally with a local company, and that governments could not give a favourable treatment to local firms—for example, in granting contracts, allowing local banks to set up more branches, etc.

— Removal of the many regulations and conditions now imposed on foreign companies by host government (e.g. movement of personnel, performance requirements, allowing foreign firms to take part in privatisation projects).

— Protection of foreign investors in regard to discrimination, intellectual property, expropriation, compensation, transfer of funds, and taxation, and full compensation if asked to close or taken over.

— Establish a dispute settlement system to make the agreement legally binding and enforceable.

The MAI is therefore very biased in favour of foreign investors'. Barriers would be removed to allow international companies to cross borders, set up projects or buy up local companies. Under MAI, they would face minimal or no regulations in host countries as to conditions for the establishment, ownership, and operation of business, as well as the repatriation of profits and capital. Moreover, the MAI would impose no obligations on the foreign investor to respect the sovereignty or social and development objectives of host countries.

Host governments would have many new and heavy obligations towards foreign investors. MAI would very significantly narrow, reduce and constrain the rights, authority, degree of freedom and policy options of host countries and governments in the following economic areas:

(i) policy on foreign investment and investment in general;

(ii) macro-economic management;

(iii) policy and performance on trade, current and capital account and the balance of payments;

(iv) development planning;

(v) policy on the balance of ownership of equity and assets between foreigners and locals amongst nationals communities within the country; and

(vi) growth and development policy at sector level (industry, agriculture, trade, finance and other services). Local firms would lose their present rights to receive more favourable treatment from their governments and to be protected from bigger foreign firms so as to survive and develop.

As the proposed MAI would cover almost all sectors (defense being an exception), the narrowing or loss of policy options in host countries would also apply to social sectors and services. This could have significant implications for social and cultural policy and practices.

ISSUES NOT COVERED BY DRAFT OECD-MAI

It is also important to note what the draft OECD-MAI does not contain. It does not address the issue of the obligations of the investors. The general philosophy of the industrialised countries is that an inter-government treaty can impose binding obligations only on the signatory States and that corporate behaviour and obligations must be regulated only by national laws and regulations that are applicable alike to both domestic and foreign investors. However, as a sop to trade unions and NGOs, the draft OECD-MAI incorporates as an Appendix setting out voluntary standards for the behaviour of Multinational enterprises. The draft of OECD-MAI, however, makes it clear that they are only voluntary guidelines and that their inclusion as an Appendix does not affect the content or character of the MAI itself.

The draft OECD-MAI does not address the issue of investment incentives or taxation either, although it does address the issue of performance requirements. One of the reasons for this approach is that most investment incentives are tax incentives and that taxation is covered by bilateral tax treaties. This is too complicated a subject to be addressed by an MAI. The draft OECD-MAI does not concern itself adequately with the environmental issues except to the extent that the draft permits the stipulation of performance requirements by host countries for environmental reasons.

On the question of the movement of natural persons, the draft OECD-MAI has certain provisions on 'key personnel and employment requirements' prohibiting restrictions on the temporary entry, stay and work of individual investors, managers, executives and specialists. These provisions however are subject to the over-riding application of the host country's immigration and labour laws, as well as the professional qualification and certification requirements of the host country. Thus, the supremacy of the immigration, labour and taxation laws of the host country has been kept beyond the pale of the proposed MAI.

REASONS BEHIND THE DEMAND FOR AN MAI BY INDUSTRIALISED COUNTRIES

The traditional reason for industrialized countries wanting an MAI include as under: (1) they are mainly capital exporting countries. A large share of the global outflows of foreign direct investment emanate from the industrialized countries (ii) They are the home countries of the large transnational operations (TNC"S) whose strategies and operations are increasingly becoming globalised and therefore whose demands for un-restricted access to markets around the world for their goods, services, technology are risings; (iii) There is rising trends in the volume of FDI flows and their destinations. Although developed countries still absorb among themselves a predominant portion of the global FDI flows, the share of developing countries is rising significantly. Thus, legal security for, and stability of treatment of, FDI in developing countries have become a matter of greater interest to developing countries.

The real reason behind the push of the industrialized countries for an MAI, because of which the MAI being demanded by them focuses more on the issue of the liberalization of inward foreign investment by host countries, is that foreign direct investment is now seen by them as a key 'market access issue'. They see FDI as a crucial ingredient for their enterprises, especially their TNCs, to gain and consolidate market access opportunities around the world, especially in developing countries that offer a good market and investment potential. Owing to the advancements in various kinds of technologies, FDI is increasingly becoming more important than trade for delivering goods and services to foreign markets. In addition, it is becoming an important vehicle for TNCs in organizing their production, distribution or functional activities on an international basis to maintain their competitive strength. As far as developing countries are concerned, it must be noted that cross border exports continue to be the principal mode of delivering goods and services to foreign markets.

Moreover integrated international production is increasingly becoming a key element of the operational strategies of TNCs, which means that TNCs look for countries not only for selling their outputs but also for sourcing their inputs, such as for example, supplies of components, parts and even finished items, computer software, and services. Any part of the value chain of a TNC is now potentially open to be located in a country that offers the best advantage for it. According to UNCTAD estimates, nearly one-third of the world trade is intra-firm trade between affiliates of TNCs, while another one-third is between TNCs and non-affiliated enterprises. It is only the balance of about one-third of the world trade, which remains outside the control, or influence of the TNCs.

FDI now has multiple objectives in seeking market access opportunities around the world: natural resource seeking, market seeking, efficiency seeking, and input or asset seeking, depending on the strategies of the TNCs and the potential offered by the host countries. Multilateral rules and disciplines on foreign investments, which on the one hand ensure freedom for making the investment and on the other, ensure legal security and stable treatment for the investment made, have therefore become important for the TNCs of the industrialized world.

Besides these economic reasons, an important tactical reason is also bringing this demand to the fore now. For the European Union and Japan in particular, their participation in the negotiations for further liberalization of the agricultural trade has to be softened for their domestic constituencies by their own demands in the new round of trade negotiations. MAI and reduction of industrial tariffs are seen by them as two key issues of advantage to them. The USA and other industrialized countries would have no compunctions in supporting these issues.

FOREIGN DIRECT INVESTMENT AND MAI

Foreign direct investment as a key 'market access issue' is therefore also compelling developing countries to push for MAI. FDI being a crucial ingredient for their enterprises, especially TNCs allow them to gain and consolidate market access opportunities around the world, especially in developing countries that offer a good market and investment potential. Owing to the technological advancements including communications and information technology, FDI is increasingly becoming more important than trade for delivering goods and services to foreign markets. In addition, it is becoming an important vehicle for TNCs in organizing their production, distribution or functional activities or an international basis to maintain their competitive strength.

Foreign direct investment (FDI) continues to expand rapidly, enlarging the role of international production in the world economy. FDI grew by 18 per cent in 2000, faster than other economic aggregates like world production, capital formation and trade, reaching a record $ 1.3 trillion. FDI flows are, however, expected to decline in 2001.

The global expansion of investment flows is driven by more than 60,000 transnational corporations (TNCs) with over 800,000 affiliates abroad. Developed countries remain the prime destination of FDI, accounting for more than three-quarters of global inflows. Cross-border mergers and acquisitions (M&As) remain the main stimulus behind FDI, and these are still concentrated in the developed countries. As a result, inflows to developed countries increased by 21 per cent and amounted to a little over $1 trillion. FDI inflows to developing countries also rose, reaching $240 billion. However, their share in world FDI flows declined for the second year in a row, to 19 per cent, compared to the peak of 41 per cent in 1994. The countries in Central and Eastern Europe, with inflows of $27 billion, maintained their share of 2 per cent. The 49 least developed countries (LDCs) remained marginal in terms of attracting FDI, with 0.3 per cent of world inflows in 2000.

Within the developed world, the Triad—the European Union (EU), the United States and Japan—accounted for 71 per cent of world inflows and 82 per cent of outflows in 2000. Within the Triad, the EU has gained both as a recipient and source of FDI. Record inflows ($617 billion) were stimulated by further progress in regional integration, while the United States and other Western European countries remain its main partners outside the region. Due to the take-over of Mannesmann by Vodafone Air Touch—the largest cross-border merger deal so far—Germany became, for the first time, the largest recipient of FDI in Europe. The United Kingdom maintained its position as the top source country worldwide for a second year. The United States remained the world's largest FDI recipient country as inflows reached $281 billion. Outflows with $139 billion decreased by 2 per cent. Japan saw its inflows in 2000 drop by 36 per cent from the previous year to $8 billion, partly due to the prolonged slow-down of the country's economic growth, but also perhaps indicative of the fact that, in spite of its welcoming FDI policies, other factors deter investment inflows. In contrast, outflows from Japan rebounded to $33 billion, the highest level in ten years. Among other developed countries, the most conspicuous events were the unprecedented levels of FDI into and from Canada, reflecting several major M&A deals, in particular with partners in Europe and the United States.

There were major differences in FDI trends among developing countries. In contrast to the experience in most other parts of the world, inflows to Africa (including South Africa) declined in 2000 (for the first time since the mid-1990s), from $ 10.5 billion to $ 9.1 billion. As a result, the share of Africa in total FDI flows fell below 1 per cent. The decline was mainly related to two countries: South Africa and Angola. In the former country, fewer privatization and M&A deals caused the slow-down, while in the latter, inflows in the petroleum, sector decline. The Southern African Development Community maintained its position as the most important sub region for FDI inflows in Africa. Its share in total FDI inflows into Africa was 44 per cent, compared to 21 per cent in the first half of the 1990s. The Community's improved attractiveness to FDI may have been principally driven by country-specific factors, but at least some FDI inflows were also motivated by the economic integration of the region.

After tripling during the second half of the 1990s, FDI flows into Latin America and the Caribbean also fell in 2000, by 22 per cent, to $ 86 billion. This was mainly a correction from 1999—when FDI inflows into the region were greatly affected by three major cross-border acquisitions of Latin American firms – rather than a shift in the underlying trend. Privatisation slowed down in 2000, but continues to be important as a factor driving inward FDI. In terms of sectors, FDI into South America was mainly in services and natural resources while Mexico continued to receive the largest share of inflows in manufacturing as well as in banking.

In developing Asia, FDI inflows reached a record level of $143 billion in 2000. The greatest increase took place in east Asia: Hong Kong (China), in particular, experienced an unprecedented FDI boom, with inflows amounting to $64 billion, making it to the top FDI recipient in Asia as well as in developing countries. This upsurge in inflows has several explanations. First, it reflects a recovery from the economic turmoil of the recent past. Second, TNCs planning to invest in mainland China have been "parking" funds in Hong Kong (China), in anticipation of China's expected entry into the WTO. Third, the increase reflects a major cross-border M&A in telecommunications, which alone accounted for nearly one-third of the territory's total FDI inflows. Fourth, there is an element of increased "round-tripping" of capital flows into, and out of Hong Kong (China).

FDI flows to China, at $41 billion, remained fairly stable. In the course of its negotiations for membership in the WTO, China has amended some of its FDI policies. TNCs play an increasingly important role in the Chinese economy; for example, tax contributions by foreign affiliates accounted for 18 per cent ($27 billion) of the country's total corporate tax revenues in 2000. Inflows to South-East Asia (ASEAN-10) remained below the pre-crisis level. The sub region's share in total FDI flows to developing Asia continued to shrink, and stood in 2000 at 10 per cent, as compared with over 30 per cent in the mid-1990s. This was largely due to rising inflows into other countries in the region and significant divestments in Indonesia since the onset of the financial crisis. South Asia witnessed a drop in FDI inflows by 1 per cent over the previous year, India, the largest recipient in the subcontinent, received $2 billion. Notwithstanding these mixed trends, the long-term investment prospects for developing Asia remain bright. In addition to the quality of the underlying determinants for FDI, greater economic integrations likely to boost FDI in the region.

Outward FDI from developing Asia doubled in 2000, to $85 billion. Hong Kong (China) was the most important source ($63 billion); more than half of its outward FDI went to China. Outward FDI from China and India also picked up.

FDI inflows into Central and Eastern Europe also rose, to an unprecedented $27 billion. Privatization-related transactions were a key determinant of FDI inflows throughout the region, with the exception of Hungary, where the privatization process has by and large run its course, and the Commonwealth of Independent states, where large-scale privatizations involving foreign investors have yet to begin. Outflows from the region expanded even faster than inflows, in spite of the fact that official data on outward FDI are likely to underestimate the actual outflows. (Some FDI by firms in the Russian Federation go unreported, or are reported under other elements of the balance of payments).

A mapping of FDI inflows indicates the extent to which host countries are integrating into the globalising world economy. It also indicates indirectly the distribution of benefits from FDI. The mapping of outward FDI shows which countries control the global distribution of this investment. Understanding the pattern of FDI flows and stocks and its driving forces is important for the formulation and implementation of economic strategies and policies.

A comparison of the world maps of inward and outward FDI in 2000 and 1985 reveals that FDI reaches many more countries in a substantial manner than in the past. More than 50 countries (24 of which are developing countries) have an inward stock of more than $10 billion, compared with only 17 countries 15 years ago (7 of them developing countries). The picture for outward FDI is similar, the number of countries with stocks exceeding $ 10 billion rose from 10 to 33 (now including 12 developing countries, compared to 8 in 1985) over the same period. In terms of flows, the number of countries receiving an annual average of more than $1 billion rose from 17 ((6 of which were developing countries) in the mid-1980s to 51 (23 of which were developing countries) at the end of the 1990s. In the case of outflows, 33 countries (11 developing countries) invested more than $ 11 billion at the end of the 1990s, compared to 13 countries (only) one developing country) in the mid-1980s.

Despite its reach, however, FDI is unevenly distributed. The world's top 30 host countries account for 95 per cent of total world FDI inflows and 90 per cent of stocks. The top 30 home countries account for around 99 per cent of outward FDI flows and stocks, mainly industrialized economies. About 90 of the world's largest 100 non-financial TNCs in terms of foreign assets are headquartered in the Triad.

The current boom in FDI flows, which has been accompanied by increasing flows of foreign portfolio equity investment, underscores the increasingly important role played by transactional corporation (TNC's) in both developed and developing countries. This role has been facilitated by liberalization of FDI policies that has taken place in many countries in recent years, as part of an overall movement towards more open and market friendly policies. However, reaping the benefits of FDI liberalization requires not only that barriers to FDI are reduced and standard of treatment established the focus of most FDI liberalization to date – but also that competition in market is maintained.

It is difficult to vesualise that the attraction of FDI by China, India or the other top bracket developing countries in Asia and Latin America will be significantly altered by their adherence or non-adherence to a multilateral agreement on foreign investment. The African developing countries, the LDCs and small developing countries, which today are on the fringe of FDI flows, are also unlikely to attract additional FDI merely because they subscribe to a liberal multilateral treaty on foreign investment. There has been a sharp increase in the flows of FDI to developing countries since the early 1990s, without there being an MAI. The chief reasons for the rising flows of FDI to developing countries and their heavy concentration in a limited number of developing countries are, firstly, the investment and market opportunities that they offer, and secondly, their own unilateral liberalization of their FDI regimes. It is this synergy of investment opportunities and investment climate of the top-20 developing countries that lies at the root of their attracting the vast bulk of the FDI flows to developing countries.

The case for an MAI cannot therefore be rested on the argument that it will significantly enhance the flows of much needed investment capital to the developing countries. An MAI cannot alter the investment opportunities side of the equation. Other more important factors being favourable, it may at best serve as a confidence building measure for foreign investors (assuming that the MAI embodies all the major demands of the foreign investors) and thereby embellish the investment climate of host countries. A key question for the consideration of developing countries is therefore:

> What is it that the MAI will achieve that cannot be achieved by the unilateral and autonomous liberalization of their FDI regimes by host countries and what is the *quid pro quo* for developing countries by being a party to an MAI?

Integrated international production is also increasingly becoming a key element of the operational strategies of TNCs. They look for countries not only for selling their outputs but also for sourcing their inputs, such as supplies of components, parts and even finished items, computer software, and services. Any part of the value chain of a TNC is now potentially open to be located in a country that offers the best advantage for it. According to UNCTAD estimates, nearly one-third of the world trade is intra-firm trade between affiliates of TNCs. While another one-third is between TNCs and non-affiliated enterprises. It is only the balance of about one-third of the world trade which remains outside the control or influence of the TNCs.

Hence FDI, now used by TNCs as multiple objectives vehicle for market access opportunities around the world, natural resources, input or asset depending on the strategies of the TNCs and the potential offered by the host countries. Multilateral rules and disciplines on foreign investment, which on the one hand ensure freedom of making the investment and on the other, ensure legal security and stable treatment for the investment made, have therefore become important for the TNCs and industrialised world, as well.

MAIN COMPONENTS OF AN MAI AS ADVOCATED BY INDUSTRIALISED COUNTRIES

The MAI as advocated by the industrialized countries and as evidenced by the mandate and draft of the OECD negotiations will have four major components: (a) the liberalization of foreign investment regimes by host countries; (b) fair and equitable treatment of investment; (c) legal security for investment; and (d) effective dispute settlement procedures. Furthermore, the definition of investment for an MAI will be as wide as possible. The draft OECD-MAI defines investment as "every kind of asset owned or controlled, directly or indirectly, by an investor", while "investor" means any natural or legal person of a Contracting Party, with the legal person being any kind of entity constituted or organised under the applicable law of a Contracting Party. Such a definition of investment is purposely intended to go far beyond the traditional notion of foreign direct investment (FDI). The definition will cover not only equity investment (regardless of whether it is above or below any specified threshold level), but also portfolio investment, debt capital, monetary and financial transactions, and more importantly, every form of tangible and intangible asset, including, in particular, intellectual property rights, concessions and licences. The only exceptions to this broad definition will be trade operations and purely financial transitions in capital and money markets, such as for example, trade credits, traded goods and foreign exchange operations. Needless to say, the definition of investment is key to the scope and ambit of an MAI.

The cornerstone of the MAI being demanded by industrialized countries is the liberalization of the foreign investment regimes of host countries through a legally binding adoption of the principle of non-discriminatory treatment (i.e. the principle of "national treatment") as between domestic and foreign investors. According to a paper circulated at the WTO by the European Union, the purpose of an MAI is to create a "level playing field" for foreign investors around the world so that they are legally assured that they will stand on the same footing as domestic investors when they wish to make an investment in a host country. This principle of non-discriminatory or national treatment is to apply to all stages of an investment, namely, entry, establishment and operation of an investment.

The main elements of the second component of the proposed MAI, namely "fair and equitable treatment of investment" are, (i) national treatment, MFN treatment and transparency in the post establishment phase, (ii) performance requirements, (iii) employment of key personnel, (iv) privatization and (v) monopolies. Of these, performance requirements, privatization and monopolies require specific attention. The draft OECD-MAI prohibits several performance requirements totally, while some other performance requirements are permitted if they are connected with the grant of fiscal, financial or other advantages by the host country. Among the prohibited performance requirements are: local content requirements, export obligations, hiring a given level of nationals, establishing a joint venture, achieving a minimum level of local equity participation and transfer of technology requirements. It needs to be noted that performance requirements are prohibited even if they apply equally to domestic and foreign investors.

On privatization the draft OECD-MAI wants to apply the national treatment and MFN principles to all kinds of privatization and all phases of privatization (i.e. to the initial sale of publicly owned assets as well as the subsequent sale of these assets). As regards monopolies, the draft OCED-MAI does not prohibit the creation of government-designated monopolies, but prescribes that such monopolies observe the rules of non-discrimination in their sales and purchases. Preferential or special treatment to domestic or nationally owned companies in purchases, for example, will come under prohibition. The only exception to the non-discriminatory treatment is when government procurement is made not with a view to commercial re-sale or use in the further production of goods and services for commercial sale.

The MAI provisions relating to the third component, namely, "legal security for established investment", will cover issues such as nationalization and compensation, free transfer of payments, subrogation and protection of existing investments.

On the question of dispute settlement, a critical component of an MAI, what needs to be noted is that the dispute settlement provisions, as indicated in the draft OECD-MAI, will cover not only State to State disputes, but also investor-to State disputes, with the investor having the right to choose the resolution of disputes either through national courts or through international arbitration. The investor will also have the right to choose the rules for arbitration out of ICSID, UNCITRAL or ICC Rules. The arbitral panel in such cases shall be appointed by the Secretary General of the ICSID or the ICC as the case may be. In the case of State to State disputes, the arbitral panel shall be appointed by the Secretary- General, ICSID. At its extreme, an investor can take a State to international arbitration for a host country rejecting his proposal for an investment on the ground of an alleged violation of pre-establishment phase national treatment obligation. It is also worth noting that while an investor can take a State to international arbitration, the State cannot do so. The State can only take recourse to available national legal remedies if it has a dispute with an investor.

Lastly, it is also important to note what the draft OECD-MAI does not contain. It does not address the issue of the obligations of the investors. The general philosophy of the industrialized countries is that an inter-governmental treaty can impose binding obligations only on the signatory States and that corporate behaviour and obligations must be regulated only by national laws and regulations that are applicable alike to both domestic and foreign investors. However, as a sop to trade unions and NGOs, the draft OECD-MAI incorporates as an Appendix the 1976 OECD 'Guidelines for Multinational Enterprises' (which sets out voluntary standards for the behaviour of such enterprises). The draft OECD-MAI, however, makes it clear that they are only voluntary guidelines and that their inclusion as an Appendix does not effect the content or character of the MAI itself.

The draft OECD-MAI does not address the issue of investment incentives or taxation either, although it does address the issue of performance requirements. One of the reasons for this approach is that most investment incentives are tax incentives and that taxation is covered by bilateral tax treaties. This is too complicated a subject to be addressed by an MAI. The draft OECD-MAI does not concern itself adequately with the environmental issues (which is the reason for environmental lobbies in the West opposing the MAI), except to the extent that the draft permits the stipulation of performance requirements by host countries for environmental reasons. Environmental lobbies have argued that unfettered freedom for foreign investors, as advocated by the OECD-MAI, would limit the ability of host countries, especially developing countries, to safeguard their natural and biological resources, and that therefore, the negotiation of any such MAI should be preceded by a comprehensive environment impact assessment.

On the question of the movement of natural persons, the draft OECD-MAI has certain provisions on 'key personnel and employment requirements' prohibiting restrictions on the temporary entry, stay and work of individual investors, managers, executives and specialists. These provisions however are subject to the over-riding application of the host country's immigration and labour laws, as well as the professional qualification and certification requirements of the host country. Thus, the supremacy of the immigration, labour and taxation laws of the host country has been kept beyond the pale of the proposed MAI.

MAI – ASIAN PERSPECTIVE

In March 1996, a workshop was organised by the OECD Secretariat in Hong Kong to explain the MAI to 12 selected "dynamic developing countries". Most of them were from the Asian region, including China, India, Malaysia, Indonesia, Korea, Singapore, and Hong Kong. Participants from some key Asian countries were cool and generally unfavourable to the proposed MAI. They raised several concerns and objections on the substance, procedures and institutional context of the proposed rules.

As explained by OECD officials. The objectives of MAI explained by OECD Officials as to liberalise the terms of foreign investment, protect foreign investors' rights and establish a legally binding dispute settlement system.

The most interesting feature is that MAI, though initiated by and negotiated amongst OECD countries, is actually intended to be of a global nature, open to all countries to join. Most non-OECD participants were critical of not having been invited to participate in the establishment of the MAI. The chairman of Malaysia's Industrial development Authority, while observing that "Whatever we say won't affect the process much," explained that Asians are sensitive to how they are drawn into a process, and there is considerable discomfort when they are asked to accede to a treaty without being given an opportunity to get directly involved in its shaping. The process could even be seen as objectionable—the equivalent of "accede without representation." He concluded that "If this MAI is intended for global accession, then it has to be a global process, and all countries need to be more directly involved."

The problem has been seen arising from difference of approaches the Western and Asian countries to negotiations. OECD took a top-down approach to the MAI, while the Asia-Pacific region preferred a bottom-up approach. The dynamic growth of the Asia-Pacific region is based on a highly pragmatic approach towards resolving problems and proceeding to the next state. Regarding the OECD proposal, Asian Countries favoured a more evolutionary and not a regulatory approach, and which could be expected to have a negative response to MAI.

Another objectionable point was that the MAI is supposed to achieve a "high standard", and this had been cited as the reason for confining negotiations to OECD countries. The worrisome assumption seemed to be that if non-OECD member countries are to be involved, standards would have been compromised. Since the entry of foreign firms could also have an effect on domestic firms, there is a local concern regarding global liberalization and a domestic dimension to foreign investment. Both aspects had therefore to be considered. The issue "is not investment liberalization *per se* but the effective and mutually beneficial management of this liberalization".

Asian countries also raised question as to whether the contents of the proposed MAI would be advantageous to developing countries, since the MAI stressed the rights and interests of foreign investors, but had nothing to say on the rights of host countries and the obligation of investors to observe the laws of host countries. One of the representatives of Asian Countries insisted that the protection of a host country's interests and rights and observance of domestic laws should be a crucial part of an investment agreement.

It was generally viewed that foreign investment does play a positive role, each country has a different situation, as they are at different stages of development. Each country has the right to set up its own investment regime based on its own social and economic conditions. Therefore balanced agreement, acceptable to most countries is important. If an agreement is of high standard but is not acceptable, then it would not be a good or successful one. The MAI should look at the rights of both sides. If only one aspect is stressed, things will go wrong.

FOREIGN INVESTMENT POLICY AND REGULATIONS – NATIONAL PREROGATIVE

The major issue in regard to the MAI or the MIA is not whether foreign investment is good or bad, welcomed or un-welcomed. The real issue is whether national governments should retain the right and power to establish policy instruments, options and regulations covering investment, including foreign investment.

Most countries presently accept the importance of foreign investment and are trying their best to attract foreign investors. However, there is evidence that foreign investment can have both positive and negative effects. A major objective of development policy is to maximise the positive aspects while minimising the negative, so that, on balance there is a significant benefit. Experience shows that, for foreign investment to play a positive role in economic and social development, governments must have the right and power to regulate its entry as well as the terms and conditions of its operation. The key problem is that the proposed MAI would remove these government rights and powers. By doing so, the negative aspects of unregulated and uncontrolled foreign investment inflow could overwhelm the positive aspects.

Most developing countries now have policies that regulate the entry of foreign firms, and include various conditions and restrictions governing foreign investment in general and on a sector-by-sector basis. Few countries (if any) have adopted a policy granting total right of entry. In some countries, foreign companies are not allowed to operate in certain sectors, for instance, banking, insurance or telecommunications. In sectors where they are allowed, foreign companies have to apply for permission to establish themselves, and if approval is given it often comes with some conditions.

Of course the mix of conditions varies from country to country. They may include equity restrictions; for example, a foreign company cannot own more than a certain percentage of the equity of the company it would like to set up. There may be ownership restrictions; for instance, foreigners are not allowed to own land or to buy houses below a certain price.

Many developing countries also have policies that favour the growth of local companies. Tax breaks may be available for local companies, but not to foreign firms. Local banks may be given greater scope of business than foreign banks. Local firms may be given preference in the allocation of government business or contracts.

Generally, governments base such policies and conditions on national sovereignty, holding that a country should control at least a significant part of its own economy. Or the policies are justified in the interest of national development, considering that local firms need special treatment at least for a time until they can compete with more powerful and better-endowed foreign companies.

Moreover, most developing countries would argue that during the colonial era, their economies were shaped to the advantage of foreign companies and financial institutions, usually belonging to the colonising country. Local people and enterprises were therefore at a disadvantage, and currently require considerable time and special treatment before they can compete on more balanced or favourable terms with bigger foreign companies. This has been the central rationale for developing countries' policies in applying restrictions or imposing conditions on foreign investments.

The MAI proposes to liberalise foreign investment flows in a comprehensive manner and would therefore have serious consequences. Governments in developing countries would find that the space for adopting their own independent policies regarding investments and foreign companies are very severally restricted. No longer will each government have the freedom to choose its own particular mixture of policies and conditions on foreign investments. The major policies would be already determined by the multilateral set of investment rules, and the choice available would be very much constrained to more minor aspects.

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TRADE RELATED ISSUES UNDER WTO AND REGULATORY RESPONSE

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I. INTRODUCTION

The world is no longer a collection of relatively autonomous neighbourhood. At the dawn of 21st century, globalization has demonstrated that the economic decisions must be taken in the global perspective. While movement of goods, services, ideas and capital across the national boundaries is not new, its acceleration has certainly been remarkable. The information and ideas can be accessed in all corners of the globe at the push of a button. The international trade and economic order is evolving into a highly integrated and electronically narrowed system. In other words, the world is becoming a global village – integrated, interconnected and interdependent.

It has been established that international trade stimulates a country's development and economic growth as well as raises living conditions of all people. Its growth is firmly buttressed by multilateral trading institutions of long standing. The World Trade Organization (WTO), built on the legacy of the General Agreement on Tariffs and Trade (GATT) is the latest step in creating an environment more conducive to the multilateral exchange of goods and services. In other words, the rule based multilateral system built up through GATT/ WTO is one of the central pillars of international trade and cooperation.

The global business community strongly believes that the rule-based multilateral trading system has contributed greatly to liberalizing international trade and improving market access, and is a major driving force for global economic growth, job creation, and wider consumer choice. It is, therefore, imperative for all WTO member States to work closely together to reaffirm in concrete form the key role of the multilateral trading system envisaged under WTO in the management of globalization and in enabling its benefits to spread equally throughout society in all parts of the world, without discriminating between developed, developing and least developed countries.

The multilateral trade negotiations under the aegis of the WTO should address the concerns of developing countries, especially their concerns arising out of the implementation of the Uruguay Round Agreements. The developing countries, which now account for about three-quarters of WTO members, carry substantial weight in WTO and it is clear that, to support multilateral trade negotiations, they have to feel strongly confident of making dependable gains in access to developed country markets, and especially for products in which they have a competitive advantage. Moreover, while WTO negotiations should extend effective market access on a mutually beneficial reciprocal basis, it must be recognized that many developing countries require special transition periods and technical assistance to enable them to fulfill their commitments.

II. DOHA DECLARATION – USHERING IN A NEW ERA OF TRADE NEGOTIATIONS

The negotiations during the Fourth Ministerial Conference at Doha and their outcome has demonstrated one thing very clear that the future trade negotiations under WTO would have to take into consideration the interests of developing and least developed countries. The developing countries during their preparatory process and also during the

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Conference adopted a highly coordinated approach making it amply clear that genuine resolution of their implementation related concerns is a must for the success of the Conference and also to maintain their confidence in the multilateral trading regime under the WTO. This yielded results, and at the conclusion of the Conference, the Ministers adopted a decision on implementation related concerns. Out of the total of 102 issues considered, the Doha Conference took decisions in respect of 43 issues. The remaining issues have been referred either to negotiations or to subsidiary bodies for further examination.

In view of the failure of the third Ministerial Conference (Seattle, 1999) to take any decision, and in the context of the concerted efforts of certain developed countries to seek endorsement of expanded agenda for WTO, the fourth WTO Ministerial Conference held at Doha, Qatar from 9-14 November, 2001, assumed considerable importance and attracted wide publicity. While there were strong pressures to launch a comprehensive round of negotiations including multilateral regimes on investment, competition policy, trade facilitation, Government procurement and environment, India was opposed to any such overburdening of the multilateral trading system with non trade or new issues in the agenda. It was felt that WTO already had a sufficiently large agenda consisting of mandated negotiations and mandated reviews and therefore, India underlined the need for resolving the implementation issues, arising from the current agreements in a time bound manner before addressing new issues for negotiations.

The Doha Declaration

The Doha Declaration comprising of a main Declaration, a Declaration on TRIPs Agreement and Public Health and a decision on Implementation related issues and concerns, launches the future work programme of the WTO and includes elaboration and timetables for the current negotiations in agriculture and services and negotiations/possible negotiations in a range of other issues.

A number of implementation issues have been addressed in the Decision on implementation related issues and concerns including longer time frame for compliance, moratorium of two years on non-violation complaints under the TRIPs Agreement, need for special care for initiation of back to back anti-dumping investigations within a year and co-operation and assistance by members in investigations relating to declared values.

The declaration agrees that negotiations on all other outstanding implementation issues shall be an integral part of the work programme. Where specific negotiations are mandated, relevant implementation issues shall be addressed under that mandate and other outstanding implementation issues shall be addressed as a matter of priority by the relevant WTO bodies, which shall report to the Trade Negotiating Committee by the end of 2002 for appropriate action.

In respect of Agriculture, the Declaration commits to comprehensive negotiations aimed at: substantial improvements in market access for developing countries; reductions of, with a view to phasing out, all forms of export subsidies; and substantial reductions in trade distorting domestic support being given by the developed countries. It also takes note of non trade concerns of developing countries and their development needs including food security and rural development. Special and differential treatment for developing countries would be an integral part of the negotiations.

The declaration on TRIPs and Public Health is one of the most significant outcomes of Doha Conference. In the declaration, ministers stress that it is important to implement and interpret the TRIPs Agreement in a way that supports public health — by promoting both access to existing medicines and the creation of new medicines. They refer to their separate declaration on this subject.

This separate declaration on TRIPs and public health is designed to respond to concerns about the possible implications of the TRIPs Agreement for access to medicines.

It emphasizes that the TRIPs Agreement does not and should not prevent member governments from acting to protect public health. It affirms governments' right to use the agreement's flexibilities in order to avoid any reticence the governments may feel.

It states that the agreement should be interpreted in a way that supports governments' right to protect public health. This provides guidance to individual members and to dispute settlement rulings.

The separate declaration clarifies some of the forms of flexibility available, in particular compulsory licensing and parallel importing.

As far as the Doha agenda is concerned, this separate declaration sets two specific task. The TRIPs

Council has to find a solution to the problems countries may face in making use of compulsory licensing if they have too little or no pharmaceutical manufacturing capacity, reporting to the General Council on this by the end of 2002. The declaration also extends the deadline for least-developed countries to apply provisions on pharmaceutical patents until 1 January 2016.

In respect of Special and Differential Treatment the Declaration says that the negotiations shall fully take into account the principle of special and differential treatment for developing countries. It has also been agreed to review all special and differential treatment provisions with a view to strengthening them and making them more precise, effective and operational.

The issues relating to Trade and Investment, interaction between Trade and Competition, Transparency in Government Procurement and Trade Facilitation (popularly known as Singapore Issues) will continue to be pursued in the Working Group Study process. Negotiation on these subjects, according to the Work Programme, will take place after the Fifth session of the Ministerial Conference on the basis of a decision to be taken, by explicit consensus, at that session on modalities of negotiations.

In respect of interaction between trade and environment, the Negotiations on limited aspects of trade and environment (relationship between existing WTO rules and specific trade obligations set out in Multilateral Environmental Agreements, procedures for regular information exchange between MEA and WTO and reduction/elimination of tariff and non tariff barriers to environmental goods and services) has been mandated, along with instructions to the Committee on Trade and Environment to pursue its work on all items on its agenda, giving particular attention to the issues of market access, the relevant provisions of the TRIPs Agreement and labeling.

In respect of Labour Standards, the Declaration recognises the ILO as the appropriate forum to address the issue of core labour standards.

III. INTERNATIONAL TRADE AND COMPETITION

Competition has long been acknowledged as an important force bringing about economic development and growth. Competition can also act as a substitute for other institutions. There is evidence that competition can substitute for an effective bankruptcy system because it exerts pressures on inefficient firms to go into liquidation. A number of studies have found a positive relationship between competition and efficiency; competition and the rate of productivity growth. In the presence of competition, firms adjust operations to raise efficiency and thus maintain profitability, and less efficient firms exit the industry. The exit of these firms frees up resources, which can then be used by more efficient firms.

International trade promotes competition in markets. Openness to international trade also helps exert pressure on governments to reform those domestic product and factor market institutions that undermine the ability of firms to respond to competitive pressures from abroad. But the effect of this source of competition is mostly limited to tradable goods. Governments worldwide need to build more effective institutions to address aspects of the international trade regime that can undermine competition. At the national level, this includes making further progress in liberalizing services as well as goods, and, for industrial countries, in providing access for developing country exports. At the international level, it includes reducing compliance and certification costs of trade-related product standards and taking advantage of the flexibility allowed in the Agreement on Trade-Related Intellectual Property Rights (TRIPs) to allow developing countries to maximize benefits.

Exposure to international markets plays a central role in promoting competition in domestic markets. Imports directly introduce international competition pressures to domestic markets. This pressure is also introduced indirectly, through exports, since domestic firms have to compete in the global marketplace. There is a sizeable body of empirical work that provides evidence that trade liberalization increases competition and, consequently, efficiency and productivity growth. Case studies show that even in a large industrial country such as the United States, international competition raises productivity.

The World Development Report, 2002 pointed out that International trade is particularly useful in promoting competitive markets in developing countries, where there are information difficulties, inadequate contract enforcement, and human capital constraints. These circumstances imply that it would be easier to use an instrument to promote competition that depends strictly on rules, such as international trade, compared with an instrument like competition law, which requires investigations and adjudication. International trade also creates pressures for governments to address institutional barriers to competition in the domestic trade because these barriers undermine the domestic economy's ability to respond to foreign competition. India provides a good example of the role of international trade in liberalizing domestic regulations on entry.

All International standards are not appropriate for developing countries. Without attention to country circumstances, some standards, such as those for intellectual property rights, can even have adverse distributional consequences. Moreover, complementary institutions or human capital to enforce these systems do not exist in many countries. In international forums human capital constraints can prevent developing country's policymakers from engaging effectively in negotiations. These are the areas that need attention if future development of international standards is to reflect developing country priorities and promote competition.

In this context, the WTO's pioneering work in analyzing the interaction between trade and competition policy in dialogue with the business community should continue in order to advance understanding of the complex issues involved and their ramifications. The setting up of Global Competition Initiative an independent forum to promote consultation, dialogue and consensus building among national competition authorities on global competition problems is a welcome step.

Cartels – A Contentious Issue Undermining Competition

A cartel in its simplest form is an agreement between businesses not to compete with each other. Ordinarily cartel agreements are verbal and formal, covering prices, output levels, discounts, credit terms, customer allocation, territorial allocation and bid rigging. The cartels can occur in every industry/sector and can involve goods as well as services at the manufacturing, distribution or retail level. However, some sectors are more vulnerable to cartels, because of few competitors in that sector, the products have similar characteristics leaving little scope for competition on quality or service; communication channels between competitors are already established; or the industry is suffering from excess capacity or there is general recession.

As the integration of global market is intensifying the issue of international cartels is assuming significance particularly in developing countries. A World Bank study estimated that around 40 different international cartels have been operating during 1990s and most of them had a clear effect on markets the world over. International cartels are particularly dangerous for developing countries, as most of them do not have enough resources to detect them. The existence of competition law is not enough to detect, control, break, punish, international cartels, what is required is international cooperation between and amongst the countries.

There are two main ways in which cartels can be treated in competition law. The first is to treat all cartels as illegal, meaning thereby practices such as price-fixing and other cartel-related behaviour violate the law regardless of the market power of participants, their motives, or the purported business justifications. This stringent treatment of cartels is found in 13 of the 50 countries surveyed, including the United States. The second way is to use the rule-of-reason analysis, meaning thereby it is up to the competition authorities to prove the harmful economic effects of cartels. This less stringent way of treating cartels is found in most countries. European Union competition law has an automatic prohibition against anticompetitive practices and agreements. It is up to the competition authorities or national courts to prove that there has been an infringement and that the behaviour does not qualify for an exemption, particularly in the case of an agreement.

IV. INTELLECTUAL PROPERTY RIGHTS

Intellectual Property Rights have gained prominence in global economic policymaking over the last one and half decade most notably because of the Agreement on Trade-Related Aspects of Intellectual Property Rights, (TRIPs) which lays down minimum standards of intellectual property protection to be provided by WTO member countries.

IPRs are generally more beneficial to developed countries because they are the producers and exporters of technology. The World Development Report, 2002 has estimated that the United States stands to gain $5.7 billion in net transfers from TRIPs, while Germany, Sweden, and Switzerland are also expected to receive substantial net inward transfers. In contrast, developing countries are expected to experience net outward transfers, amounting to \$430 million for India, \$434 million for Korea, \$481 million for Mexico and \$1.7 billion for Brazil.

No doubt ensuring a core level of IPR protection may increase developing country access to foreign technologies by safeguarding returns for foreign technology producers, but excessively strong IPRs can inhibit the diffusion of knowledge, because in developing countries, knowledge is built more through access, imitation, and diffusion of foreign technologies rather than only through research and development activities. Legitimate ways to transfer of technology under some IPR systems such as reverse engineering or inventing around patents are restricted under strong Intellectual Property Rights.

The World Development Report, 2002 pointed out that in developing countries competition laws and policies in general do not address monopoly abuse of Intellectual Property Rights. A survey of competition laws in developing countries indicated that only 5 out of 33 countries prohibit IPR agreements that restrict competition, compared with 9 out of 21 industrial countries. The lack of capacity to enforce competition laws also constrains the ability to control restrictive practices. Unless developing countries rapidly establish adequate competition frameworks and regulatory institutions that also address monopoly abuse of IPRs, it is possible that increasing IPR protection could result in welfare losses from monopoly behaviour. In this context, it is worth mentioning that the proposed Competition Bill, 2000 has taken care of intellectual property rights.

There are also some potential gains to developing countries from stronger IPR protection. For example, if adaptation of imported technology to local needs requires a significant amount of investment, domestic companies will be willing to undertake the investment if they are assured of protection of their intellectual property rights. Strong intellectual property regime benefit developing countries by protecting indigenous property rights and traditional knowledge. Developing countries hold approximately 90 percent of world biological resources, which are particularly important in the development of new pharmaceuticals. In this context, the institutions can be built to protect the collective intellectual property rights for traditional knowledge held by cultural groups.

Developing countries have made a commitment to implement TRIPs. To maximize their net gains, these countries need to take advantage of the flexibility built into TRIPs. There are several areas of flexibility within TRIPs that provide the potential for developing countries to maximize benefits by promoting access to technology and preventing anti-competitive practices.

Countries can also use compulsory licensing, allowed by TRIPS under some circumstances, to control anti-competitive behaviour that results from IPRs or in national emergencies, such as public health crisis. The OECD countries have legal provisions for compulsory licensing under some conditions, and many developing countries, including Argentina, Chile, China, Poland, and South Africa, have already introduced such provisions. The United States has granted number of licences under antitrust decrees. In India, the Patents (Amendment) Act, 2002 provides for additional grounds for grant of compulsory licences.

V. MONEY LAUNDERING

Money laundering has become a global problem as a result of the confluence of several explicit changes in world markets. The growth in international trade, the expansion of the global financial system, the lowering of barriers to international travel, and the surge in the internationalization of organized crime have combined to provide the source, opportunity, and means for converting illegal proceeds into what appears to be legitimate funds. Money laundering can have devastating effects on the soundness of financial institutions and undermine the political stability of democratic nations.

It threatens the countries on three fronts. First, on the enforcement front, laundering increases the threat posed by serious crime, such as drug trafficking, racketeering, and smuggling, by facilitating the underlying crime and providing funds for reinvestment that allow the criminal enterprise to continue its operations. Second, laundering poses a threat on economic front by reducing tax revenues and establishing substantial underground economies, which often stifle legitimate businesses and destabilize financial sectors and institutions. Finally, money laundering undermines democratic institutions and threatens good governance by promoting public corruption through kickbacks, bribery, illegal campaign contributions, collection of referral fees, and misappropriation of corporate taxes and licence fees.

Money laundering by its very nature occurs outside the normal range of economic statistics. Nevertheless, rough estimates have been put forward to provide glimpses of the scale of the problem. The International Monetary Fund estimates that the amount of money laundering occurring on a yearly basis could range between 2 and 5 percent of the world's gross domestic product or somewhere between $600 billion and $1.5 trillion. The US Department of the Treasury has suggested that $600 billion represents a conservative estimate of the amount of money laundered each year, and some US law makers believe that, not only does the amount lie somewhere between $500 billion and $1 trillion, but that half is being laundered through US banks. Due to the clandestine nature of laundering activity, government and concerned organizations cannot accurately quantify the amount of money laundered each year. Some estimates suggest that the amount of money laundered each year is approximately $2.8 trillion, an amount more than four times greater than the figure generally accepted.

The inability to determine the actual amount of money laundered impedes the desired understanding of the magnitude of the problem, its macroeconomic effect, and the effectiveness of current anti-money laundering efforts.

Need to Fight Against Money Laundering

The possible social, economic and political effects of money laundering, if left unchecked or dealt with ineffectively, are serious. Through the process of money laundering, organized crime can infiltrate financial institutions, acquire control of large sectors of the economy through investment, or offer bribes to public officials and indeed governments. Thus, the economic and political influence of criminal organizations can weaken the social fabric, collective ethical standards, and ultimately the democratic institutions of society. Most fundamentally, money laundering is inextricably linked to the underlying criminal activity that generates it. Laundering thus enables criminal activity to continue and needs to be dealt with heavy-handedly.

Anti Money Laundering Initiatives – Global View

Since money laundering is an international phenomenon, trans-border co-operation is of critical importance in the fight against this menace. A number of initiatives have been taken to deal with the problem at the international level. In this context, the United Nations and the Bank for International Settlements, took initiatives in 1980s to address the problem of money laundering. However, with the creation of the Financial Action Task Force (FATF) in 1989, regional groupings, such as the European Union, Council of Europe, Organization of American States also established anti-money laundering standards for their member countries.

The major international agreements addressing money laundering include the United Nations Convention Against Illicit Trafficking in Drugs and Psychotropic Substances (the Vienna Convention) and Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds of Crime. The role of financial institutions in preventing and detecting money laundering has also been the subject of pronouncements by the Basle Committee on Banking Supervision, the European Union and the International Organization of Securities Commissions.

The Financial Action Task Force

The main international body engaged in continuous and comprehensive efforts both to define policy and to promote the adoption of counter measures against money laundering is the Financial Action Task Force (FATF). The FATF, set up by the governments of the G-7 countries at their 1989 Economic Summit, is an inter-governmental body engaged in the development and promotion of policies to combat money laundering. These policies aim to prevent proceeds of crime from being utilized in future criminal activities and from affecting legitimate economic activities. The FATF consists of 31 Member States and two international organizations. Its membership includes the major financial Centre Countries of Europe, North America and Asia. Participants include representatives from members' financial regulatory authorities, law enforcement agencies, and ministries of finance, justice and external affairs. Representatives of international and regional organizations concerned with combating money laundering also attend FATF meetings as observers. The main tasks of the FATF are :

— Monitoring members' progress in applying measures to counter money laundering.

— Reviewing money laundering techniques and countermeasures.

— Promoting the adoption and implementation of appropriate measures by non-member countries.

Anti-Money Laundering – Initiatives by India

In view of an urgent need for the enactment of a comprehensive legislation for preventing money-laundering and connected activities, confiscation of proceeds of crime, setting up of agencies and mechanisms for co-coordinating measures for combating money laundering etc., the Government introduced in Parliament the Prevention of Money-laundering Bill 1998. The Bill was referred to the Standing Committee on Finance, which presented its report on the 4th of March, 1999 to the Lok Sabha. After incorporating the recommendations of the Standing Committee, the Government again introduced the Prevention of Money Laundering Bill 1999 in the Parliament on October 29, 1999.

The violations regarding the Narcotic Drugs and Psychotropic Substances Act, 1985 constitute most serious offence under the Bill.

The Bill contains a provision relating to the obligations of banking companies, financial institutions and intermediaries to maintain records and furnish information of all such transactions as specified by the Government. The Bill also provides for immunity to the officers, from civil liability arising out of disclosure of information.

The Bill provides for appointment of Adjudicating authority having powers of a Civil Court, and the proceedings before the Adjudicating Authority to be deemed as judicial in nature under Indian Penal Code. The Bill also provides for the establishment of Appellate Tribunal to hear appeals against the orders of the Adjudicating Authority and authorities as prescribed under the Bill. The Bill also provides for the establishment of designated Special Courts for trial of offences punishable with imprisonment ranging from 3 to 7 years and fine upto 5 lakhs for money laundering including offences specified under the Narcotic Drugs and Psychotropic Substances Act, 1985, which attracts imprisonment upto 10 years and fine upto Rs.5 lakhs.

VI. ANTI-DUMPING

There has been sharp increase in anti-dumping investigations initiated by WTO member countries. The year 1999 witnessed 360 initiations of anti-dumping investigations, up 42% over the year 1998. The European Union and India each reported the highest number of initiations at 68, followed by the United States with 45 initiations. Counted together, the European Union and its member states were the most affected by initiations and anti-dumping investigations (47) followed by the Republic of Korea (34) and Japan (23). However, data for the year 2000 and January 1, 2001 to June 30, 2001 indicate a down trend in initiation of anti-dumping investigations by WTO member states – a total of 272 initiations were notified during the year 2000 and 134 initiations were notified during the period January 1, 2001 – June 30, 2001.

As far as India in concerned, it stands third in terms of actions initiated with 16 cases after US (39 cases) and Canada (23 cases). In terms of action initiated against India, it stands fourth with 8 cases after China (22 cases), South Korea (10 cases) and Taiwan (9 cases). The data indicates that the India is one of the major players in using as well as facing the anti-dumping measures. It is, therefore, imperative for India to take a balanced approach on issues concerning anti-dumping laws, practice and procedures.

When a company exports a product at a price lower than the price it normally charges on its own home market, the practice constitutes dumping of goods. Is this unfair competition? The WTO is silent on the issue, rather focuses on how the government can or cannot react to dumping. In fact, the WTO agreement disciplines anti-dumping actions. Article VI of the GATT contains some contingent measures, which allow member states to withdraw their normal obligations under specified circumstances and impose higher protection against import of one or more goods from one or more countries.

The agreement on implementation of Article VI of GATT 1994 allows member states to apply anti-dumping measures on import of a product with an export price below its normal value, if such imports cause or threaten to cause material injury to a domestic industry. This agreement sets forth detailed rules concerning determinations of dumping, injury and casual lines, and the procedures to be followed in initiating and conducting anti-dumping investigations.

The procedure under Uruguay Round agreement requires that anti-dumping investigation must involve a written application by the domestic industry, giving evidence of dumping, injury/threat of injury and a causal link between the two. Domestic industry for this purpose must account for more than 50 percent of the domestic production of a product, if it accounts for less than 25 per cent, the application shall not be entertained. The domestic industry should be able to provide data in respect of domestic price and injuries price of the product concerned. Before initiating investigation, the government of the exporting country must be notified.

In India the Designated Authority on anti-dumping has been entrusted with the duty to investigate the existence, degree and effect of subsidy on any article; to identify the articles liable for any duty or additional duty; to submit its findings to the Central Government as to the nature and amount of subsidy in relation to such articles.

The Designated Authority initiates an investigation upon receipt of written request by or on behalf of the affected domestic industry provided it has satisfied itself on the existence and quantum of subsidy, the injury caused and a causal link between such imports and the alleged injury. It has also been empowered to initiate suo moto investigation if it is satisfied that there is an incidence of dumping.

The problem of dumping has been fallout of the economic liberalisation process, which led to major changes in business milieu due to dismantling of tariff and non-tariff barriers. Hence it has become imperative that effective implementation of anti-dumping cases be taken up by the Government and proactive measures be initiated so as to provide a level playing field for the domestic manufacturer.

In this context, it is desirable that a comprehensive and efficient legal and regulatory mechanism is provided to deal with case of dumping expeditiously. Here it is worth mentioning that while the Ministry of Commerce deals with matter pertaining to dumping, the safeguard and countervailing duties are in the domain of the Finance Ministry. The situation gets further complicated because of umpteen definitional problems in defining dumping, in determining injury to local industry and in establishing industry specific causal link between dumping and injury. Hence there is need for greater inter ministerial coordination so that the procedures laid out are timely and transparent with clear provisions for imposition of punitive measures depending upon the nature of injury so that action can be redressal of the problem.

The time taken in recommending provisional and final measures against dumped imports is too long leading to grievous injury to the concerned industry during the intervening period. This is in sharp contrast to average time taken by countries such as USA, Australia. New Zealand and Chile which take speedy action for early redressal. There is, therefore, need to strengthen the infrastructure and manpower.

The availability of adequate information and data about the cost of production, domestic price of the product prevailing in the country of manufacture etc. which is required to satisfy the Designated Authority for a *prima facie* decision of initiating investigations is a big problem for domestic industry. It is, therefore, imperative to devise a more efficient mechanism for information dissemination and collection of requisite data to enable Indian companies to contest their cases on a stronger footing. In this context, it is desirable that the Government agencies, particularly Indian Embassies abroad, should provide the necessary assistance to help industry get requisite data/information to expedite the process of making petition to anti-dumping Directorate.

Under WTO regulations, the authorities can only impose duties on the countries from where actual imports have taken place during the investigation period. But it is a common practice by most MNCs that in order to circumvent the anti dumping duty imposed on imports from a particular destination, MNCs effect import from other countries. It is, therefore, desirable for the WTO to draw up specific guidelines restricting MNCs from importing its product from its other plants, once anti-dumping investigation is being carried out for the product manufactured by the company.

VII. TRADE AND ENVIRONMENT

Environmental concerns have long been the subject of international interest, partly because of the burgeoning world population. But at the end of the 20th century, global concerns have acquired a new urgency. Over the past 20 years, the content and quality of the discourse on the environment have been completely transformed. The authoritative scientific evidence available on environmental problems commands the attention of government and the public alike. Moreover, along with globalisation has come a new recognition of the shared responsibility for the environment. A number of international, governmental, and non governmental organisations with a deep interest in these issue have appeared on the scene. These bodies have made full use of the United Nations system and the abilities of new communications technology to reach people all over the world.

Climate change, the loss of biodiversity and other related issues have been recognised as problems that the community of nations must take on collectively. Left unattended, they will worsen the planet. Many of these issues are closely linked to the potential success of development efforts in poor countries, and the growing awareness of these linkages is part of the continuing shift in the development perspective.

Only ten years ago the development community often brushed environmental concerns aside, emphasising instead the primacy of growth, stability and poverty reduction. Central to the discussion of environmental sustainability at the start of the 21st century is the problem of how to devise mechanisms that distribute the burdens of reform equally without discouraging the participation of every country that has the capacity to cause environmental damage.

The direct link between trade and environment in the original GATT treaty can be traced in the exception clauses under Article XX, which allows countries to enforce measures that restrict trade, provided they correspond to certain specific opt-outs. The environmental opt-outs includes measures necessary to protect human, animal or plant life or health; and measures relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restriction on domestic production or consumption.

The GATT Council in 1971 decided to set up a group on Environmental Measures and International Trade. Simultaneously, a large number of Multilateral Environmental Agreements (MEAs) came into existence in view of the growing environmental consciousness in many developed and developing countries. These agreements include provisions that can affect trade as for example they prohibit trade in certain products or allow countries to restrict trade in certain circumstances. The notable agreements include — The Montreal Protocol to phase out the use of Ozone Depletion Substances; the Biodiversity Convention for Conservation of Biological Diversity; the Convention on International Trade in Endangered Species; The Basel Convention on the Transboundry Movement of Hazardous Wastes; and the London Guidelines on the Exchange of Information on Banned or Severely Restricted Chemicals.

In view of the increased emphasis on environmental policies the final Uraguay Round Agreement takes into account the environmental issues. The Ministerial Declaration on Trade and Environment ensures that linkage between trade policies, environmental policies and sustainable development will be taken up as a priority within the WTO. Following the declaration a Committee on Trade and Environment was set up to bring issues relating to environment and sustainable development into the main stream of WTO activities. The WTO Committee on Trade and Environment has a broad base responsibility covering all areas of the multilateral trading system namely, goods, services and intellectual property. Its duties are to study the relationship between trade and the environment; and to make recommendations about any changes that might be needed in the trade agreements.

At the Fourth Ministerial Conference held at Doha, the member states with a view to enhancing the mutual supportiveness of trade and environment, agreed to negotiations, without prejudging their outcome on:

(i) the relationship between existing WTO rules and specific trade obligations set out in multilateral environmental agreements (MEAs). The negotiations shall be limited in scope to the applicability of such existing WTO rules as among parties to the MEA in question. The negotiations shall not prejudice the WTO rights of any member that is not a party to the MEA in question;

(ii) procedures for regular information exchange between MEA Secretariats and the relevant WTO committees, and the criteria for the granting of observer status;

(iii) the reduction or, as appropriate, elimination of tariff and non-tariff barriers to environmental goods and services.

Doha declaration instruct the Committee on Trade and Environment, in pursuing work on all items on its agenda within its current terms of reference, to give particular attention to :

(i) the effect of environmental measures on market access, especially in relation to developing countries, in particular the least-developed among them, and those situations in which the elimination or reduction of trade restrictions and distortions would benefit trade, the environment and development;

(ii) the relevant provisions of the Agreement on Trade-Related Aspects of Intellectual Property Rights; and

(iii) labelling requirements for environmental purposes.

The declaration further said that work on these issues should include the identification of any need to clarify relevant WTO rules. The Committee shall report to the Fifth Session of the Ministerial Conference, and make recommendations, where appropriate, with respect to future action, including the desirability of negotiations. The outcome of this work as well as the negotiations shall be compatible with the open and non-discriminatory nature of the multilateral trading system, shall not add to or diminish the rights and obligations of members under existing WTO agreements, in particular the Agreement on the Application of Sanitary and Phytosanitary Measures, nor alter the balance of these rights and obligations, and will take into account the needs of developing and least-developed countries. Recognizing the importance of technical assistance and capacity building in the field of trade and environment to developing countries, in particular the least developed among them, the declaration provides for expertise and experience sharing with members wishing to perform environmental reviews at the national level.

CONCLUSION

India played a proactive role in the deliberations at the fourth Ministerial Conference. It was able to ensure adoption of an agenda that emphasised not only trade but also the developmental goals and priorities of developing countries. With the Doha Declaration laying down the agenda for the forthcoming trade talks, the focus will now shift to the work programme in WTO. India along with other developing countries should work to ensure that their interests and concerns are adequately taken care of in the work programme. The opportunity also needs to be taken for expediting the pace of reforms process to further strengthen the country's competitiveness in global trade.

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TOWARDS TRIUMPH AMID TURBULENCE : REPOSITIONING THE PROFESSION OF THE FUTURE

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INTRODUCTION

One of the basic indicators of the maturity and evolution of any profession is its continual capacity to remorph itself to the constantly changing requirements of the industry or the sector it serves. Times have never been as challenging for the professionals in the corporate sector and the profession of Company Secretaries as the tumult of corporate debacles, one after the other, and the crumbling down of once seemingly invincible edifices of commercial giants seems to echo and underline today. With the gauntlet of maintenance of good governance, as the key to standing tall in the turbulent seas of today's business world, squarely thrown on the corporate turf, it is incumbent upon the profession of company secretaries to not only pick up the gauntlet but also to unflinchingly demonstrate to the ensuing scenario that the profession of Company Secretaries is eminently suited to be at the core of the sources of competitive advantages of the modern day corporation, in its capacity of being the principal driver of corporate governance and the custodian of ethical well being of the company, with a sharp proactive focus on the unfolding future.

All challenges brought about by change embody opportunities sometimes masquerading as problems to scare away the unprepared and which can only be seized by those prepared to ride valiantly on the winds of change. In this paper an attempt has been made to present a backdrop of challenges created for the modern day corporation by the inexorable forces of globalisation, the imperatives of existing in the information age and indeed by the changing aspirations of the present day stakeholders themselves and then relate the same for the evolving implications and opportunities for the able profession of company secretaries. Let us briefly look at some of the interesting developments in the environment within which the modern day corporates find themselves; some of which they themselves may have helped create, and try to decipher some portends for ourselves. The theme of the article has been discussed under the following four sub themes:

I. *The challenges of operating in the information age;*
II. *The complexities brought about by the globalisation imperative;*
III. *GATS and the professional services implications, and*
IV. *The issue of the ethical dimension.*

I. The challenges of operating in the information age : The information society or the information age as it is more commonly referred to, is not just a product of information technology but rather an outcome of a dynamic interplay of a set of intermeshed and interacting social and technological dynamics which includes in information processing and telecommunication and an increasing convergence of the two; progressively escalating levels of specialization in the economy, which itself is becoming increasingly knowledge based and the emergence of a better informed and vigilant society which not only requires but demands better governance.

The information age creates a society and corporate climate, which is richly interconnected. The prime characteristics are an explosion in the availability of information, sharp compression in both time and space and

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rapidly rising levels of turbulence and unpredictability. It is this unpredictability which renders past experience non applicable in dealing with situations sans precedent and novel circumstances. Some of the facets of the information age which impact corporate businesses and have specific implications and challenges for the governance dimension are discussed here, as these are imperatives for the profession of company secretaries to address :

Information age as a driver or a key facilitator of globalisation : While the complexities brought about by the globalisation imperative are discussed under the next section, reference here is only to the information age driven developments in the process of globalisation.

Looking at the information age related consequences in our social and economic milieu one is forced to acknowledge the information age driven developments in the globalisation of world economy, interconnected stock exchanges across most of the world, nearly border-less capital markets, increasing rationalization of business on a regional or even a global basis; possibilities of global sharing of technologies and businesses following such transfers of technology; the growing necessity of supranational forums like the WTO and GATS; ever present and busily humming information networks often making a trans - border transaction faster than conducting a local grocery shop transaction-the list is long and impressive.

Each of these developments translates into an enlargement of the role and responsibility of the company secretary in dealing with the portends of good governance in the information age, in managing information and disclosure flows with literally the speed matched by the requirements of an interconnected world and dealing with both conventional and unconventional corporate structures, the world over, seeming to exist in a chaotic but working order.

Democratisation and Regionalisation: Information age on the one hand creates border-less societies, on the other makes it possible for sub national governments to access sources of advantage anywhere in the world. One has to only look at the changing corporate scenario in the states like Karnataka and Andhra Pradesh to appreciate the tremendous leap that these states have taken, courtesy the IT savvy state governments seeking to bring in the advantages of international funding in their own states. This change has resulted in a shift of the power profile of the regional governments and also brought about a change in the work culture of the public organizations, the industry - state relationship and the partnership between the public and private domains of enterprises. Professionals in the corporate domain, company secretaries included, need to adapt fast to such interrelated corporate and neo corporate networks that are emergent as a fact of innovative search of financing solutions by business supportive state interventions.

A meltdown of structure and beaurocratic form of organization : In their quest of sustainable competitive advantage and faster speed of response, organizations both public and private, are downsizing, outsourcing, networking or simply relying on more decentralized, flatter, leaner structures to enable themselves to have higher levels of market responsiveness and client focus as well as to retain advantages of flexibility to remain in sync with a world of changes bringing in unexpected opportunities as well as the threat of getting their competitive advantages wiped out. In such structures novelty of legal contracting, maintenance of informational disclosures, warehousing of relevant and sharable decision inputs becomes a key capability in buoying up levels of corporate performance. As the hub of the corporate legality, the Company Secretary seems to be ideally placed to emerge as the repositor of all the validation and legal requirements regarding company operations in multiple locations ,varying time zones and constantly shifting structural forms.

The growing importance of human resources : Both public and private sectors are rapidly becoming aware that while information technology makes countless opportunities seem within the realm of possible realities, IT in all its splendor is only an enabler. It is the human factor, capable of utilizing and managing vast amounts of information for corporate advantage adept at establishing effective and productive working relationships, within and outside the organization, creating and implementing information that translates the ephemeral opportunities into growth and success. As a key human resource, thus, along with the managerial and technical human resources, the company secretary with requisite enlargement of his role as the repository, disseminator and manager of all requisite legal information, as the custodian of good governance as well as the one responsible for placing valid information as the basis of board room decision making; would define the difference between a dynamically resurgent company and a merely successful one in times to come.

The swan song of secrecy : In the information age, countless ways and multiple channels of information access have sought to bid a gradual farewell to the era of secrecy. People in the public domain, as consumers, competitors, investors and other stakeholders have far greater access to information than they ever did in the past. Progressive legislations, demands of competitive parity and indeed the imperative to seek and join the global main stream have made information not only a requirement for corporate stakeholders but also a right to be demanded and exercised. From a manager of confidentiality and secrecy to a hub of disseminable and sharable requisite information, there is a paradigm shift in the role of the company secretary, which is sometimes the matter of a mind state difficult to adjust to. Understanding the imperative to change and rising to the occasion by becoming a stakeholder friendly, reliable and readily available information resource for sharable information is the role profile that the professions would have to adopt and master.

II. The complexities brought about by the globalization imperative : The following section focuses on the operational complexities brought about by the corporations going global as well as the FDI flow across borders becoming a fact of corporate life.

FDI the world over increased 700% after 1985, which is twice the rate of increase of foreign trade which itself grew at twice the rate of the growth of world economy. The first consequence of FDI is an increased complexity of operating at the same time in many countries. Companies like Nestle and ABB operate in more than 150 countries. Indian companies like Reliance, Ranbaxy and Tata find their presence across many a national border bringing with it the complexity of operating in the sheer number of countries, currencies, tax policies, languages, time zones and cultures. For such trans-national corporations sometimes operating in environments with different disclosure and reporting requirements and indeed with varying levels of stake holder vigilance, the function of company secretaryship needs a decisive shift of focus from local to trans-national, with competencies in leveraging cross border learning in the discharge of its multifarious functions. From a repositor and provider of information to various functionaries and stake holders, the professionals would require to be dynamic managers of relevant information fulfilling the needs of varying disclosure norms and reporting requirements with exercise of prudence and discretion.

Need to recreate competitive advantage : When firms operate in markets other than their own domestic market, they often need to recreate their competitive advantage. The source of Toyota's greatest competitive advantage in Japan has been it's superior value to price ratio, which is made possible by its lean, efficient manufacturing system, the work culture of the Japanese workforce and the company's excellent supplier chain network when operating from the Toyota city. These advantages also apply when Toyota exports from Japan. When it, however, chooses to establish operations in India, or the UK, it does not have the advantage of either the supplier network or the Japanese workforce, it must create these or compensating advantages in the new locations. Whenever firms establish a direct presence elsewhere they need to understand the possible transferability of their sources of competitive advantage. Although Toyota in different markets was able to recreate a hardworking team oriented work force through their organizational culture, Benetton has not been able to recreate the advantages of it's Italian supplier chain anywhere else in the world and must therefore look for alternative but equally compelling advantage or sub optimize.

One of the sources of competitive advantage under such scenario could be the level of professionalisation of the various services available in the host countries. The contention here is that, to a incoming corporate in India, a key resource base should be the quality of company secretarial professional services available, which through it's complete mastery of legal and secretarial operations would not only free the corporate think tank from the concerns of legality of corporate actions, but also render timely and requisite advisory services, regarding governance and other corporate requirements in the host country.

Geopolitical uncertainty and the corporate concerns : In the FDI driven globalising process, a third concern is the rising geopolitical uncertainty. In the past, during the cold war era, multinationals generally kept their businesses insulated from political issues in the countries of their operation, preferring to drop anchor only in waters that were welcoming or at least not hostile. With the end of the cold war era and the ensuing of a new world trade order, the political and business interests have become inextricably enmeshed and there is a growing tribe that feels that the commercial agenda often drives the political agenda and sometimes *vice versa*. Corporations now must face the added complexity of needing to articulate a geopolitical strategy when operating in different regions. The previous section saw the company secretary needing to take on the role of a dynamic information manager. In the context of the geopolitical situation above he would be, in addition, required to, like a strategic analyst preemptively assess the direction of change in government policy and render timely advice to the top management as some of these changes may well affect legal and operational requirements. The competencies required would range from active networking of information analyses, from interpretation of policy statements to assessing the seeds of policy change, masked as subtle indicators in the winds of change coursing through corridors of power.

III. GATS and the professional services implications : International trade in professional services is potentially a billion dollar industry, including international contracts for consultancies, movement of natural persons and possibility of corporate monopolies in offer and execution of professional services. In the specific context of professional services once India has become a signatory to the trade in services, border less trade in services would cover all four forms of supply envisaged in the GATS. Each mode is open to implications for the profession of Company Secretaries. To consider each briefly:

Cross border supply of services : This mode relates to provision of service when the service crosses the border and does not require the movement of the customer. With the rapid internationalization of professional services and with suitable accretion in the competence profile of the company secretaries, this provision opens the door for possible "exporting" of professional services of the company secretaries in the form overseas consultancy and advisory services. Proactive marketing of the member's core competencies is a necessary corollary of the efforts towards converting this opportunity into realizable potential. Possibility also exists for creating online technology supported educational inputs to offer the Company Secretary certification overseas, provided concerns of quality assurance, accreditation and cross - border recognition of qualifications offered are addressed. The technological possibility is today available, the legal framework could soon become available under the GATS environment, the need of the hour is to evaluate the desirability and net value of such an endeavor.

Consumption abroad : As a mode relates to the service involving the movement of the consumers to the country of the supplier. As the incoming trans-national corporations and wholly owned subsidiaries from the world over seek to establish their foothold in India, company secretaries can see the enlargement of their operations not only in dealing with the Indian joint ventures but also in catering to the requirements of the wholly owned subsidiaries or corporations with majority holdings outside. This welcome enlargement in their sphere of operations also embodies a challenge that any such corporate presence setting up operations in India would be compelled, on the sheer weight of the competence of the professionals, to make the selection of the professionals, as their first choice and not merely for pandering to a paper formality while continuing to use their own professional services for key advisory functions.

Commercial presence : Relates to the situation when the service provider establishes a commercial presence or has commercial facilities in other countries in the form of a local branch or a partnership with a local provider. Instances of company secretary professionals establishing branches abroad are notable by their scarcity, largely due to inherent nature of the enactment creating this profession. Under the GATS provisions, enabling clauses could make it possible for the same to be realised, provided a need gap can be identified in other countries, to be fittingly filled by the competence profile of the professionals here. Possibilities would exist both for provision of professional services through commercial presence and for provision of Secretarial education through overseas branch offices.

Presence of natural persons : Relates to the mode of persons travelling to another country on a temporary basis to provide service. Possibilities for the company secretary professionals are abundantly indicated as consultants, legal and corporate advisors, issue managers and so on. This is a potentially strong market, given the possibility of movement of professionals and also given their ability to deal with the corporate structures and legal requirements of the world corporation. Broad based consultancy firms today display sufficient width of knowledge to leverage trans - border expertise, wherever the need for such expertise is demanded. The profession of company secretaries will need to broaden its horizons to realize the possibility of offering their expertise world over wherever the demand-pull takes them, by leveraging their knowledge base in India and adding to it the inputs on requirements of the world corporation.

A word of healthy caution to the profession here however should not come amiss. We need to be conscious of the fact that all trans-border trade in services through all the modes provided for as above, is intended to be a two way traffic. While there are opportunities for the profession to be looking outwards, there is also the competitive threat of service providers from overseas making inroads into the Indian markets, once GATS becomes fully operational in India. Only cutting edge excellence and constant investment in our own competence profile are the surest ways of insulating our market shares from competitive posturing from abroad, and the time to take proactive action is almost upon us now.

IV. The Issue of Ethical Dimension of Business : We have so far concentrated on the external environment created imperatives. I would now like to focus upon something that profoundly affects the internal culture of the organization but also has powerful external consequences in terms of corporate image and goodwill. The reference here is to ethical conduct of business. Today, more than ever before, ethics in business has emerged as a core element of performance management. Ethics in corporate functioning is becoming a major concern of many, both in the public and private domain, on account of perceived decline in levels of competence, performance and confidence in public institutions, including corporate ones, coupled with widely reported instances of corruption and scandals. Ethics in business has thus emerged as a major issue in delivery of services to the public and to all stakeholders.

The designing of a well functioning ethics infrastructure will lay the foundation of encouraging high standards of corporate behavior. By developing the code of conduct, the profession has taken the first definitive steps towards the establishment of this infrastructure. Some general principles of managing ethics for the modern day corporation have been suggested by the International Personnel Management Association, which could act as a guiding factor in managing the ethical infrastructure*. To quote some.

— Ethical standards should be clear so that employees know the principles they are expected to apply to their work. Code of conduct should be a shared, open document.

— Ethical standards should be reflected in the legal framework, which is the basis for communicating the minimum standards and principles of behaviour for all employees.

Managers should demonstrate and promote ethical conduct, and management policies, procedures and practices should reflect the organization's commitment to ethical standandards :

— Adequate accountability mechanisms should be in place so that decision makers are accountable for their actions to their superiors and ultimately, the public. Accountability should focus both the compliance with ethical principles and achievement of results.

— Appropriate procedures and sanctions should exist to deal with wrongdoing and allegations of wrongdoing.

Since the emergence of corporate governance as one of the key elements of competitiveness, effectiveness of governance has been recognised as critical to corporate growth and prosperity, the present day imperatives of operating in an increasingly open and globalizing economy have unambiguously demonstrated that ethical business and profitable business are not adversarial but are indeed necessary complements to each other. The responsibility of ensuring ethical standards of behaviour in a corporation falls within the lexicon of the well-understood umbrella that now represents the professional role profile of the company secretary. The very challenge of rising to all the role requirements is by itself the motivation that will keep the profession on the cutting edge of professional excellence.

Repositioning the profession as a competitive differentiator

A careful analysis of the backdrop presented by the four sub themes above clearly indicates the evolutionary position in which the profession finds itself today. The company secretary, from being a trusted advisor and a custodian of the legality of corporate action would, on account of the imperatives of existing in the information age; which creates unique challenges for corporate governance and maintaining timely disclosures; the complexities in the organizational structures brought about by the globalization imperative, the implications of GATS and the extremely relevant dimension of business ethics, needs to be repositioned as a complete resource to enable the corporates to handle these challenges with confidence. A confidence which would only emerge out of the assured belief that as a company secretarial professional, they truly have the arsenal of managing the above complexities and challenges of governance, attracting investment, ,maintaining stakeholder confidence and managing geopolitical uncertainty besides implementing highest tenets of ethical behaviour.; which would enable them ,to stand tall among their competitors. Having a well qualified company secretary, with the enlarged competence profile as indicated in the sections above, would thus emerge as a key competitive differentiator, spelling the distinction between running companies and resurgent, achieving corporations, not only able to take full advantage of the abovementioned developments present to them, but also able to create their own opportunities and write their own recipe of success.

As the necessity of being not only consistently profitable but also being consistently "well run" according to the well understood global tenets of good governance and ethical practices becomes increasingly more compelling, and emerges as a determinant of attracting overseas investments or strategic alliances; those responsible for creating and implementing the governance and ethics infrastructure, i.e. the company secretarial professionals move centre stage as the key sources of competitive advantage of the modern day corporation. Reference has specifically been made under each one of the four sub themes of this paper, about the positioning stance that would need to be altered in terms of broadening the training base, including additional inputs and acquiring additional competencies. There is, not a shadow of doubt that as the complexities and the unpredictability multiply, as the rate of environmental changes accelerates and as the world marches ahead towards higher levels of integration of trade and economy, the very mosaic of the varied responsibilities demanded of the profession will make it achieve importance of new magnitude. I would again like to refer, under the sub theme II of the globalization imperative, to the sections on need to recreate competitive advantage and geopolitical uncertainty in order to bring home the point of how the role of the profession is slated to evolve, if the profession is willing to broad base its competence profile now and thus acquire the mantle of an indispensable source of competitive advantage in times to come. In the context of the ethical dimension, by enunciating the code of conduct the profession has already demonstrated the lead it has in the concerns of ethical business. By assuming a key, proactive role in implementing the ethical infrastructure as indicated in sub theme IV, the

* Lord Nolan "Just and honest government in public administration and development": The International journal of Management research and practice; Vol. 18, No. 5 December, 1998.

profession stands to further consolidate its position as a competitive differentiator, where having a qualified company secretary on one's corporate rolls would automatically signal to all stakeholders an insurance that good governance and healthy ethical practices have indeed been provided for and can possibly be taken for granted. This paper through its analysis under the four sub themes only tries to provide a direction of the repositioning that the profession would need in the context of the developmental paradigms that seem to define our business today, if the profession is to occupy its rightful place as a key differentiator of competitive excellence.

In conclusion, I would like to underline the challenges surrounding the world of the professionals to an intricate and waiting to be untangled " vyuha sanrachana" created by the forces of time and change. The prepared shall overcome and even master the waves of change, which bring in the opportunities as they bring in the threats. While the corporate saga of the future unfolds, it would be sure to find the profession and those who practice it, emerging as a critical link in the corporate value chain as the corporations set about to conquer the competitive combats that are the stuff modern day businesses seem to thrive on.

SECRETARIAL STANDARDS REPOSITIONING THE PROFESSION

ALKA KAPOOR*

We have entered into a dynamic world of unfettered global competition where standards of probity and fiduciary responsibility have become critical. Effective legal and regulatory regime coupled with responsible governance have become essential for instilling confidence and assurance in investors that corporations will behave honestly and with integrity in regard to their owners. Business responsibility is increasingly being considered not to include profitability alone, but to incorporate issues compatible with societal objectives and legitimate social concerns. Transparency and accountability are considered essential characteristics of good corporate governance. However, to remain competitive and to edge above the rest, companies have many a times ignored norms of good governance and adoption of sound corporate practices. The recent financial scams in United States, the largest economy influencing the corporate world at a global level, have brought to fore the fact that the malaise is prevalent in both developed and developing nations.

The unsavory developments have, to an extent, eroded the faith of the investors and the governments in corporate professionals, as the persons responsible for providing efficient leadership and has brought into sharp focus the integrity and credibility, or absence thereof of, of professionals. It, therefore, becomes imperative for professionals and especially the Company Secretaries, to reorient and reposition themselves so as to inspire a culture of professional integrity and ethical practices in their corporate action. The challenge before the professionals, thus, is to benchmark standards of excellence in every sphere of their activities and to restore the confidence of the investors, stakeholders, regulators and the public at large.

It is here that the demand on professional bodies such as the Institute of Company Secretaries of India (ICSI) becomes crucial. They are expected to play a vital role in not only ensuring adequate supply of top quality professionals but also laying down standards of professionalism and encouraging uniformity and consistency of corporate practices.

In India, it is heartening that the Government places substantial reliance on the professional bodies and their members in ensuring adoption of healthy practices by the corporate sector. The professional bodies are being perceived as the extended arms of the regulator. To fulfill its role as an extended arm of the regulator towards ensuring adoption of best secretarial practices and ethical standards by corporate entities, the ICSI established the Secretarial Standards Board with the objective of formulating Secretarial Standards.

Establishment of the Secretarial Standards Board – A Visionary Step

The establishment of Secretarial Standards Board by the ICSI, in the year 2000 is a visionary step. There is no similar Board or authority in existence any where in the world for the purpose of formulating Secretarial Standards, though uniformity of accounting practices, by formulating Accounting Standards, is sought to be achieved through the International Accounting Standards Committee, as well as Accounting Standards Boards/ Committees of various countries including India. Being the pioneers, the SSB would be able to set up international benchmarks in secretarial practice which, in times to come, are likely to be emulated by other countries.

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The Secretarial Standards Board is a body of professionals with a wide and varied representation. It comprises, besides experienced members of the profession, the representatives of regulatory bodies such as the Department of Company Affairs and the Securities and Exchange Board of India as well as the nominees of sister professional bodies, the Institute of Chartered Accountants of India and the Institute of Cost and Works Accountants of India. Representation of the Industry on the Board is also being sought.

The main function of SSB is to identify the areas in which Secretarial Standards need to be issued and to formulate such Secretarial Standards. In addition, SSB will clarify issues arising out of such Secretarial Standards and also issue Guidance Notes. The Guidance Notes shall provide detailed Guidance on the compliance of the corresponding Standard. Some Guidance Notes may not have the corresponding Secretarial Standard but may be issued by SSB primarily to provide guidance to members on matters arising in the course of their professional work.

The Secretarial Standards formulated/to be formulated by SSB would not substitute or supplant the existing law and the rules and regulations framed thereunder, but, on the contrary, would supplement such laws, rules and regulations.

What are Secretarial Standards?

Secretarial Standards are the policy documents relating to various aspects of secretarial practices in the corporate sector. These Standards lay down 'a set of principles' which companies are expected to adopt and adhere to in discharging their corporate responsibilities.

Need for Secretarial Standards

Companies today follow diverse secretarial practices. These practices have evolved over a period of time through varied usages and as a response to differing business cultures. As an illustration, the Companies Act, 1956, provides that companies must convene their Board Meetings by giving Notice to Directors in this regard. However, no minimum period for giving such Notice has been laid down and, hitherto, companies were at liberty to give any or no length of notice for convening a Board Meeting. Further, there is no requirement for sending Agenda for the Meeting. Companies, therefore, follow varied practices with regard to giving Notices and sending Agenda and Notes on Agenda for Meetings of the Board of Directors. Some companies specify the business to be transacted in the Notice itself, while others send a separate Agenda. In addition, some companies also send detailed Notes, explaining each item on the Agenda. While some companies send the Agenda in advance of the Meeting, others place the Agenda at the Meeting itself. Even in case of those companies which send the agenda in advance, the period varies. These divergent practices need to be harmonised by laying down the best practices in this regard.

An imminent need was, therefore, felt to integrate, consolidate, harmonise and standardise all the prevalent diverse secretarial practices in this regard, so as to ensure that uniform practices are followed by the companies throughout the country. Such uniformity of practices, consistently applied, it was felt, would result in the establishment of sound corporate governance principles.

Formulation of Secretarial Standards – The Consultative Way

The SSB formulates the Secretarial Standards by seeking the views and suggestions of various professionals, trade and industry organizations, Government departments and the public at large so as to obtain wide expertise.

While formulating Secretarial Standards, SSB examines the various divergent practices in vogue and identifies the best practices which need to be adopted. For the purpose, it takes into consideration the applicable laws, customs, usages, business environment and practical applicability.

The first step in the formulation of Secretarial Standards by SSB is to identify and prioritise the broad areas in which Secretarial Standards need to be issued. Once a topic is identified, it is taken up for discussion and a Preliminary Draft is formulated. This Preliminary Draft is then circulated to various professional bodies, Chambers of Commerce, regulatory authorities such as Department of Company Affairs, Department of Economic Affairs, Securities and Exchange Board of India, Reserve Bank of India and to such other bodies/organisations as may be decided by SSB as well as to the Regional Councils/Chapters of the Institute for ascertaining their views. SSB then considers these views and meets the representatives of such bodies/organisations, if necessary, to examine and deliberate on their suggestions. Taking into consideration the comments and suggestions received, an Exposure Draft is prepared and published in the 'Chartered Secretary', the monthly journal of ICSI, and also hosted on the website of the Institute inviting comments by members of the Institute and the public at large. The views and suggestions received are once again deliberated by SSB and the draft of the proposed Secretarial Standard is finalised and submitted to the Council of the Institute for approval and issue. The Council then deliberates upon the matter and sends its recommendations to the SSB. The suggestions are again discussed and the Secretarial Standard on the relevant subject is then issued and established under the authority of the Council of the Institute.

Secretarial Standards Issued by the Institute

SSB has so far formulated two Secretarial Standards, namely, 'Secretarial Standard on Meetings of the Board of Directors' and 'Secretarial Standard on General Meetings' which have been issued by the Council of the Institute for adoption by the corporate sector.

Secretarial Standard on Meetings of the Board of Directors (SS-1)

A number of divergent practices are being followed by corporates in convening and conduct of meetings of the Board of Directors which have been harmonized by laying down the best practices in SS-1.

The Standard lays down principles for the convening and conduct of meetings of the Board of Directors and matters related thereto. The Standard dwells on the issues of necessary notice period, frequency of meetings, quorum, attendance, accounts, passing of Resolution by circulation, recording of Minutes of the Board Meeting etc.

Briefly, the Standard provides for the following, among others:

— A Board Meeting should be convened by giving at least 15 days notice. The agenda should be sent at least 7 days before the date of the meeting.

— Notice should be given to all Directors, whether in India or abroad and may be sent by hand, post, facsimile or e-mail. Where Notice is given by electronic mode, a hard copy of the Notice should also be sent by post.

— To avoid any item of significance being considered and approved without the prior knowledge of Directors, the Standard provides that prior Notice for such item is essential.

— The quorum should be present at every stage of the Meeting. Any business transacted by a number lesser than the quorum is void.

— Leave of absence to Directors should not be granted as a ritual. It should be granted only when specifically sought by a Director.

— Every company should have a Chairman who would be the Chairman for meetings of the Board.

— To ascertain the 'will of the majority', Resolutions to be passed by circulation should be sent to all Directors, whether in India or abroad.

— Recognising its importance, the Standard crystalises the date on which a Resolution sent for passing by circulation shall be deemed to have been passed.

— The Resolutions passed by circulation should be placed before the next Meeting of the Board for noting and should be reproduced as part of the minutes of that Meeting.

— Annual, quarterly or half-yearly financial results should be approved at a meeting of the Board or its Committee and should not be approved by means of a Resolution passed by circulation.

— The limited review report, in case of material variance, should be discussed and approved at a Meeting of the Board and not by Resolution passed by circulation.

— Within seven days from the date of the meeting of the Board, the draft Minutes thereof should be circulated to all the Directors for their comments.

— Minutes, if maintained in loose-leaf form, should be bound at intervals coinciding with the financial year of the company.

— The Minutes of meetings of any Committee should be circulated to the Board along with the Agenda for the next meeting and should be noted by the Board.

— Apart from the Resolution or decision, the Minutes should mention the brief background of the proposal and the rationale for passing the Resolution or taking the decision.

— As decisions taken by the Board are collective decisions, Standard provides that the names of the Directors who dissented or abstained from the decision should be recorded.

— The Minutes of all meetings should be preserved permanently.

Secretarial Standard on General Meetings (SS-2)

Diverse secretarial practices prevail in the corporate sector with regard to the convening and holding of General Meetings. With a view to integrate and standardize these practices, the Standard, SS-2 prescribes a set of principles for the convening and conduct of General Meetings. In addition, the Standard seeks to further shareholder's democracy by laying down principles for better corporate disclosures.

The salient features of this Standard are –

— Notice of every General Meeting should be given to every member at the address provided by him whether in India or outside India and Notice should also be placed on the website of the company, if any. If the venue of the meeting is not a prominent place, a site map of the venue should be enclosed with the Notice. Notice should also be given to the Directors and other specified recipients such as banks and financial institutions and other interested parties.

— In case of listed companies with more than 5,000 Members, an abridged version of the Notice should be published in a newspaper having wide circulation within such States of India where more than 1,000 Members reside.

— All Directors of the company should attend all meetings of shareholders and be available to reply to shareholders' queries. If any Director is unable to attend the Meeting for reasons beyond his control, the Chairman should explain such absence at the Meeting.

— Framing of Resolutions and explanatory statement in simple language in the Notice is emphasized for the benefit of members.

— The attendance of practicing company secretary who has given the compliance certificate has been made mandatory at every Annual General Meeting. The Standard also makes it obligatory for the auditors of the company to attend the Annual General Meeting if there are any reservations, qualifications or adverse remarks in the Auditor's Report.

— Onerous responsibility has been placed on the Chairman of the meeting who is expected to be fair and impartial in the conduct of his duties. He is enjoined upon to provide a fair opportunity to Members who are entitled to vote to raise questions and/or offer comments and ensure that these are answered.

— The Chairman should explain the objective and implication of each resolution, before the resolution is put to vote.

— The Standard specifies a two-way proxy form and specifies that the proxy holder should also sign the instrument of proxy.

— The Standard deals in depth with the concept of voting by poll.

— In case of listed companies with over 5,000 Members, the result of the poll should be published in a leading newspaper circulating in the neighbourhood of the registered office of the company.

— Resolutions specified in the Notice for items of business which are likely to affect the market price of the securities of the company should not be withdrawn.

— No gifts, gift coupons or cash in lieu of gifts should be distributed before, at or in connection with the General Meetings.

— Annual Report of companies should disclose the particulars of all general meetings held during the last three years.

— Best practices for entering, recording and signing as well as preservation of the Minutes have been laid down.

Guidance Note on SS-1 and Postal Ballot

To facilitate corporates to comply with the Secretarial Standards, the Standards are sought to be supplemented by Guidance Notes on the subject. The Guidance Note on SS-1 namely, the **Guidance Note on Meetings of the Board of**

Directors has been issued by the Council. This Guidance Note deals with procedures, interpretations, practical aspects in connection with Meetings of Board of Directors and refers to the various case laws and clarifications issued thereto. The Guidance Note is Standard specific as it provides guidance and interpretation on each Standard of the Secretarial Standard SS-1. Specimen of Notices, Agenda and Minutes in connection with convening and conduct of Meetings of Board of Directors have been given as Annexures.

The SSB has also finalised a Guidance Note on SS-2, i.e. Guidance Note on General Meetings. This Guidance Note is likely to be issued shortly.

Another Guidance Note namely, **Guidance Note on Passing of Resolutions by Postal Ballot** has also been issued, which though not preceded by a Secretarial Standard, has been issued considering the relevance of the subject to the profession and the corporate sector. The concept of postal ballot is a unique provision which gives the shareholders the right to vote on items of business of a body corporate without attending its general meetings. This Guidance Note is an exhaustive treatise on transacting the items of business through voting by postal ballot. It details all the legal and procedural aspects involved including approvals to be sought at Board Meetings convened for the purpose; the persons to whom the Notice should be sent, contents of Notice, cut-off date, advertisement procedure and the circumstances and conditions subject to which duplicate Notice and postal ballot form could be issued. Voting rights of members as on the cut-off date have been explained in detail with the help of an illustration. The check points for scrutinizing the valid and invalid postal ballot forms have been identified and details of maintenance of records by the scrutiniser have been specified. Besides, the Guidance Note incorporates specimen of Board Resolution, Notice, Advertisement to be issued in newspapers, postal ballot form, the declaration of result of postal ballot, Scrutiniser's Report and particulars to be recorded in the Minutes Book. It also summarises the entire postal ballot process in the form of a time-frame.

Compliance with Secretarial Standards

The Secretarial Standards are currently recommendatory. Recognizing the fact that the users are unfamiliar with the need and effect of such Standards, the SSB has decided to introduce these Secretarial Standards to the corporate world in the form of recommendations for compliance. Some companies have already 'begun complying with the Secretarial Standards that have been issued so far, as is evident from Annual Reports published recently. It is, however, felt that the corporate sector, judging their usage and value addition, would itself feel the necessity for adopting these Secretarial Standards. Once the Standards gain acceptability and their importance has been recognised, these would be made mandatory.

Secretarial Standards and repositioning of the profession

The Secretarial Standards are poised to reposition the profession at a higher pedestal and to act as a differentiator with the other professions throughout the world. It is perceived that the Secretarial Standards would help lay the road map for sustainable development of the profession with benchmark towards quality and it is expected that through the adoption of these Secretarial Standards, the members of the profession would play a pivotal role in heralding the adoption of best secretarial practices throughout the country, making a further contribution to good corporate governance.

A Company Secretary has always represented the highest standards of professional competence and it is therefore vital that these Secretarial Standards are upheld by all the members of the profession. Good governance for the corporate sector cannot depend on laws and regulations alone. A good corporate culture is essential and it is the Company Secretaries who can play a key role in instilling the good corporate culture through adoption of best practices and standards within the organization. They should ensure that companies behave as good corporate citizens and do not trespass the moral and ethical boundaries, besides legal and statutory limitations and that they adopt the best practices of governance.

Secretarial Standards are likely to become mandatory in due course. Over a period of time the Standards would attain the world wide stature comparable to Accounting Standards. When the Secretarial Standards are made mandatory, it would become the duty of every Company Secretary to ensure compliance with these Secretarial Standards in their respective companies. It would also become the duty of every Company Secretary in Practice, while issuing compliance and other relevant certificates to ascertain that Secretarial Standards are implemented in the company and, in the event of any deviation from the Standards, to make appropriate disclosures in his report or certificate. The Standards would thus streamline the job of Company Secretaries (both practicing and in employment) in terms of ensuring compliances besides enhancing the status and stature of the profession.

It is hoped that in the recognition of the need and importance of Secretarial Standards, the resultant uniform secretarial practices would find a place pride in every publication of substance and would be referred to internationally, leading to enhanced visibility of the profession of Company Secretaries. In times to come the judiciary too would accept the Secretarial Standards as essential adjuncts to sound governance.

This will enable the Institute to pursue and to take the profession of Company Secretaries to greater heights and work towards becoming the premier Institute for company secretaryship and administration in the world.

Unfurling the agenda

The Secretarial Standards Board, has a voluminous and important agenda before it. It proposes to work towards formulation of Secretarial Standards in respect of various legal requirements and has identified several topics on which Secretarial Standards/Guidance Notes would be issued in a phased manner. These topics include Directors, Directors' Report, Dividend, Maintenance of Statutory Registers, Related Party Transactions, Inter-corporate Loans and Investments, Annual Return, Buy-back of Shares, Issue and Allotment of Shares, Debentures and Fixed Deposits.

End Note

It is heartening to note that various companies, to name a few, Tata Metaliks Ltd., Kotak Mahindra Finance Ltd, BSES Ltd., have not only adopted the Secretarial Standards but have reported the compliance of these Standards in their Annual Reports for Financial Year 2001-2002. The ultimate goal of formulation of Secretarial Standards is to lead the profession of Company Secretaries to a position where Company Secretaries are seen as corporate professionals committed to and insisting upon the highest technical and ethical standards and leading the corporates towards adopting best practices. However, the best results can be achieved when companies begin to treat the Secretarial Standards not merely as another legal document/ compliance but as a way of corporate life and for this to happen, the responsibility lies on you, the members of the profession of Company Secretaries.