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Theme

Lead Corporate India - Role of Company Secretary

LEAD CORPORATE INDIA —
ROLE OF COMPANY SECRETARY

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Leadership—corporate leadership—is a tough job; nobody will deny. Being in continual proximity to the board, the Chairperson, the CEO, the Managing Director and executive management, the Company Secretary takes high-end initiatives to imbibe lessons of leadership. This is obviously so because it is leadership that makes the difference to the life of a corporate. It is leadership that takes matters forward, that makes time and attitudes cheerful, bright, and positive; makes performance, satisfaction, innovation, and delight seem like a matter of course. As a professional who has a continual ringside view of the boardroom and an opportunity to participate in the top team responsible for governance, Company Secretary is expected to contribute to the difference the corporate leadership can make to the life force of the corporate. To lead is to create and to enable creativity; to make impossible the possible; to be a champion and to create champions; to be cheerful and promote cheer; to be a solution and to enable problem-solving; to envision and create visionary lifestyles; perform and to enable performance; to create great team while being a part of it. Company Secretary gets the enviable opportunity to lead as a part of the corporate team at the helm.

The OECD Principles of Corporate Governance (2004 version) has the following to say on the importance of Company Secretary to corporate leadership:

"Board members require relevant information on a timely basis in order to support their decision-making. Non-executive board members do not typically have the same access to information as key managers within the company. The contributions of non-executive board members to the company can be enhanced by providing access to certain key managers within the company such as, for example, the company secretary and the internal auditor, and recourse to independent external advice at the expense of the company".

"The designation of a lead director is also regarded as a good practice alternative in some jurisdictions. Such a mechanism can also help to ensure high quality governance of the enterprise and the effective functioning of the board. The Chairman or lead director may, in some countries, be supported by a company secretary".

The global Principles of Corporate Governance Revised 2009 suggested by the International Corporate Governance Network emphasize the role of Company Secretary in the following words:

"All board members must receive the information that they need properly to understand the company's operations and progress, and also need a channel to seek independent expertise and advice where appropriate. Where the position exists, the company secretary acts as a crucial resource for the chair and for the board as a whole, providing practical guidance as to their duties and responsibilities under relevant law and regulation and playing a critical role in ensuring that the board receives the

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information and independent advice that it needs. Where companies do not have an individual who carries out such functions they should consider appointing one."

The role of Company Secretary as near and dear to corporate leadership is widely gaining international recognition. Whether he/she is employed by the company or is in public practice, a Company Secretary is a crucial source of both advice and assistance to corporate leadership. Being a conduit between top leadership and executive management and between the corporate and its various stakeholders, a Company Secretary occupies a position of great authority and responsibility in ensuring corporate success and progress. Leadership paraphernalia thus descend upon a Company Secretary almost by the order of the Providence. He/She has to take on the cudgels, the mantle, and the adjacent courage and cheer of a leader as a Company Secretary is looked upon by the highest ups, and the lower down, the peers and the outsiders with huge expectations. Corporate leadership in turbulent times, in jubilant times and, for that matter, in all times becomes a matter of habit and passion for the Company Secretary. The 37th National Convention of Company Secretaries will be regarded as an assimilation of tributaries to this ever-flowing river of knowledge that enhances Company Secretary's role in corporate leadership.

Business schools teach, train, expose, and build you as leaders in management and executive function. The scope of this function extends to the CEO level from bottom-up. Governance leadership will be of a much higher order. It is collective and is practiced at the board level. Governance leaders are, so to speak, leaders of leaders. The quality and content of leadership at this level assume a vastness of mind, a much serious attitude albeit borne with ease, an alacrity that enthuses the executive leadership to steer even through tough crises, a cultivated perspicacity, and virtual clairvoyance. Executive leadership looks from the perspective of the board within the company; governance leadership looks from the perspective of the shareholders and other stakeholders and integrates the organization into the present and future environment and ecology.

Company Secretary being near and dear to the board as well as the executive leadership, occupies a unique position. To enrich his functional effectiveness Company Secretary may learn what business schools teach but must not forget that he is also involved with governance leadership that the board supplies. B-schools teach taking decisions that involve risks, introducing changes that affect thousands, constantly thinking of ways to take the enterprise forward and make it better than the best. They will teach you business strategy, change management, dealing with situations and challenges, managing a humongous workforce, team building, personal effectiveness—in short the executive leadership. Governance includes all this but is much above, much vaster, and greatly expansive in nature. As Company Secretary you have to absorb what governance leadership will require, in addition.

To make my point clear and emphasize how governance leadership is leadership of leadership I quote an example [albeit an extreme from an extraordinary period] from Arie de Geus' The Living Company:

"Consider, for example, the case of the Swedish company Stora. If you feel overwhelmed by the turbulence in your business environment today, then think of the shifting forces with which Stora had to cope. The first written mention of the company dates from 1288. In those days it was a copper mine based in Dalecarlia, a province of Central Sweden.

When it was a mere 270 years old, during the fifteenth century, the company had to fight the king of Sweden to maintain its independence and identity. Kings throughout Europe, enmeshed in the struggle to establish centralized nation-states, were grasping for every penny they could lay their hands on, and their demands threatened the existence of enterprises like Stora. Thus Stora took on a political role within Sweden, drawing not just on its leaders' financial resources, but also on significant support from peasant workers in its home base, the province of Dalecarlia. Ultimately, the master miners of Stora found an appropriate answer to external turbulence in the manner in which they organized themselves. As one historian wrote:

"A Guild was established at the Moutain … adopting an independent and militaristic profile. For the members, loyalty to the Guild superseded the law of the land, and the word of the Master of the Guild weighed heavier than that of a judge."

During that period of unrest, it would have been catastrophic for the company to concentrate on its business in an introverted fashion, oblivious to politics. Instead, the company reshaped its goals and methods to match the demands of the world outside. It did the same thing again and again, throughout the centuries, from the Middle Ages through the Reformation, into the wars of the 1600s, the Industrial Revolution, and two world wars in the twentieth century. To appreciate the difficulties of adaptation, consider how little data was available to the Swedish managers of Stora. Instead of telephones, aeroplanes, and electronic networks, they had to depend on runners, horsemen and ships to carry messages. They barely had the facilities for a global view of their business, let alone a view of the global business environment. Nor, apparently, did the boards have the time to spend deliberating the needs and demands of society. Yet timely reaction to the conditions in society was necessary for the survival of the company and sometimes even of its individual members.

Over the next several centuries, while it coped with shifting social and political forces, the company continually shifted its business, moving from copper to forest exploitation, to iron smelting to hydro power and eventually to paper, wood pulp and chemicals. Its production technologies also shifted--from steam to internal combustion, then to electricity and ultimately to the microchip."

Classics in Leadership

Dibyendu Ganguly in the Economic Times of August 14, 2009 highlights how corporate leadership lessons in training programmes of global management institutions use classical literature in leadership development. In Shakespeare's Henry V there is a scene where the king addresses his troops before the Battle of Agincourt. Henry's army has walked 300 km through the rain and slush over the previous two weeks without food and sick from a local virus, and are badly outnumbered by the French army. Still the king exhorts to them to take the enemy head-on with these lines—

"he today that sheds his blood with me shall be my brother."

The army stays loyal to Henry though his speech includes a line saying "he which hath no stomach for this fight" let him depart, his passport shall be made' and crowns for his convoy. We would not die in that man's company that fears his fellowship to die with us." Against all odds the English went on to defeat the French army on the field of Agincourt and the lines that Shakespeare attributes to Henry V in his play are taught in numerous courses on leadership, 400 years since they were penned.

That inspirational speech may be too inspiring, written as it was by the Master—the bard of Stratford-upon-Avon. Inspiration is the essence of leadership. Be it Jim Fisher or James March or Sandra Sucher, the leading Corporate Leadership programme directors from business schools across the world have been banking on literary classics. Dibyendu Ganguly writes about such leadership programmes of the popular stalwarts in his famous article in The Economic Times.

Jim Fisher uses the speech of Henry V worded by the Bard, in his course on leadership at Rotman's School of Management, University of Toronto. Shakespeare's plays pierce the mysteries of humanity. They teach us why we sometimes do great things. Jim Fisher thinks that Shakespeare plays provide a great theme that is universal and timeless. The Bard had a magical gift for providing deep insights in very few words. Fisher also teaches leadership through theory and case studies from business but none of that seems to work as well as Shakespeare. The lecture on Henry V stays with people because it makes a point in a memorable way. People do remember a great story.

James March pioneered a course on leadership. This course did not rely on management theory or even business case studies. Instead, he uses literature, or rather, some of the most memorable characters from literature, starting with Miguel Cervantes' Don Quixote.

Don Quixote is a Spanish land owner who dreams that he is a knight. The Don may be seen an unlikely model of leadership, but the story of Don Quixote is actually one of an idealist who transcends the accidental variables of birth that March talks about to try and become something greater than he was born to be. [A perfect idol for Company Secretaries who may set out to lead corporate India]. Don Quixote sets out to fight wrongs in society and help the oppressed, with a labourer named Sancho Panza as his companion and aide. His over-wrought imagination often plays tricks on him—he fights wind mills, seeing them as evil giants—but he does manage to effect some good along the way. When people will try and convince him he's no knight, all Don Quixote has to say is: "I know who I am. A knight I am, a knight shall I die."

Cervantes story ends with Don Quixote regaining his sanity[!] and returning to his village, realizing he's not really a knight . He loses his reason for living and dies soon after. But his magical life has gone on to inspire movies, operas, ballets, a hit Broadway musical. March has created a film "Passion And Discipline: Don Quixote's Lessons For Leadership". March points out that the man of La Mancha had two key ingredients of leadership, his passion and his Knightly code of honour.

After March pioneered the way, business schools across the world have been using literature to teach leadership, ethics and moral values. In IIM Ahemdabad Doctor I S Manikutty has created leadership courses using classics like Bernard Shaw's Saint Joan and Bertolt Brecht's Life Of Galileo and Arthur Miller's All My Sons including Vishakha Dutt's Mudra Rakshas and Girish Karnad's Tuglaq.

What has Tuglaq to do with a leadership course? [Mohmad-bin-Tuglaq ascended the throne by killing his father during prayer time. This abominable act ensured that he never had any credibility among his subjects. He survived an assassination attempt that became a turning point in life leading him to embark on a reign of cruelty that left his kingdom devastated.] Dr. Manikutty points out that Tuglaq's life is a lesson on an aspect of leadership that business schools otherwise find hard to tackle—a leader's struggle to gain ascendancy and hold on to it. Organizational power struggles for top position happen. But Tuglaq demonstrates that if they violate norms of decency, the leader looses the faith of his people.

Tuglaq thus teaches business leaders that the issues of integrity, ethics and governance will always be important. Integrity calls for degree of transparency and appropriate financial and non-financial disclosures. While Shakespeare's Henry V will always lord the hearts of corporate leaders who would make it a point to manage growth in turbulent times, Miguel Cervantes' Don Quixote could be an indirect role model for corporates who would lead the markets under competition regime.

Western and other global leadership programmes are not only now drawing inspiration from Western thought classics, there is another welcome surprise in global leadership programmes that needs to be taken note of. These frontal leadership programmes are now turning and heavily banking upon Indian Classics like the BhagwatGita. Dibyendu Ganguly tells us that practical learning lessons are now being inserted in high profile business leadership programmes that make the corporate leaders to interpret and apply lessons that Lord Krishna taught Arjun on the battlefield of Kurukshetra. Leadership not only requires heroism; it also demands passion and compassion, integrity and ethics. While Henry V or Don Quixote fought battles against an evil enemy 'out there' on the battlefield, Arjun was destined to fight battle against his own kin and childhood companions. This put Arjun into an unenviable dilemma. Leadership not only consists in winning a battle against an enemy 'out there', true leadership demands better heroics in conquering enemies 'within' the individual self. One of the clear messages of the BhagwatGita [Chapter VI, Verses 5 and 6] is that the real enemy who is fiercer than the fiercest is one's own lower self. If one is able to recognize this enemy, wedge a heroic battle against him, this very enemy becomes his friend and leads him to peace, tranquility and progress. On the other hand, if this 'friendly enemy [!]' overtakes the individual, he becomes the worst devastating enemy of the individual and keeps killing and destroying individual's peace, tranquility and progress. The lesson for the leader is to sacrifice his false ego-delusion in order to be able himself to selflessly lead his ownself performing his corporate role with passion, compassion, and social responsibility. Corporate Leadership then becomes an all-pervasive learning and performing function that envelops all echelons of the corporate edifice.

Another eastern classic Tai-Te-Ching as told by the Taoist philosopher Lao Tzu gives a similar message for a leader:

"My words are very easy to know

Very easy to follow.

Yet the world is unable to know them.

The rare ones who know Me must

treasure Me .

Therefore Evolved Individuals

Wear a coarse cloth covering

With a precious jade at the centre;"

Lao Tzu [speaking in the Voice of Tao] calls those who would lead themselves and the social organism around them to peace, happiness and prosperity, 'Evolved Individuals'. [The BhagwatGita calls them variously as 'Stithpradnyas', 'Pundits', 'Munis'.]. Lao Tzu expects them to be simple, externally non-glamorous, to be knowing without knowing, humble selves ["wear coarse cloth covering"]. Evolution of the leader's inner self is the only toughest challenge amongst turbulent business times and market competition for ascendancy. But Lao Tzu makes the most difficult the simplest. ["My words are very easy to know, very easy to follow, yet the world is unable to know them"]. But Evolved Individuals earn this 'precious jade' of self-knowledge and own it as their own treasure hidden under the garb of simplicity, humility while being in the thick of work. Dynamism and growth, leadership and progress issue forth from the tranquil self within. The un-tranquil self on the other hand, creates turbulence and losses to one and all in the social organism. The tranquil self welcomes, does not resist or grieve, external turbulence or competition. It is therefore no surprise that even the big-ticket corporate leadership programmes are turning to the oriental classics for reorienting leadership talent.

DISCLOSURES

One sub-theme of the National Convention evokes discussion on financial and non-financial disclosures.

Disclosures are the substratum of integrity, ethics and corporate governance. We are aware that lack of transparency in the global financial system resulted in various overwhelming untowards. Huge losses to investors; failure of banks and investment banks that were supposed to be 'too-large-to-fail'; loss of trust and mutual lending confidence among banks in the Western markets; and global financial crisis, et al led to the great recession that began in September 2007 spreading from the advanced nations into the entire global economy. The Bank for International Settlements, Basel, Switzerland, quantifies the loss in value of investor money by the horrific difference between notional (disclosed balance sheet) value of investment in asset backed securities of US$592 trillion and their market value of (only) US$34 trillion [refer A Report by the Investors Working Group sponsored by CFA Institute Centre for Financial Market Integrity and Council of Institutional Investors, July 2009].

The need for integrity in financial disclosures was, perhaps, for the first time underlined so vehemently. First and foremost, prices of complex derivatives were not transparent. They were not known to the whole market. The real values of assets on the books of financial institutions were not known, let alone the value of the assets on the books of the corresponding third party. The credit markets froze because investors were not sure of the value of assets on the balance sheet of the counter party. These markets were opaque and no one knew what the pricing was.

World over, regulators are now framing policies that detract from the henceto popular OTC markets and are favouring exchange traded market. A clear preference is developing for a centrally counter-party guaranteed exchange traded market. The truth cannot be hidden with profit; hiding or twisting the truth about finances, asset and liability values leads to neck-breaking consequences. In the wake of the global financial crisis controversies have loomed large about fair value reporting, mark-to-market accounting, valuation of derivatives and complex financial instruments and so on. It is clear that Company Secretaries have to step in now to promote transparency and fairness in financial reporting.

The Companies Bill, 2009 introduced in the Parliament faithfully incorporates the Company Secretaries into the triumvirate of corporate governance along with the CEO and the CFO. Company Secretaries therefore have to show compelling collective leadership qualities along with the CEO and CFO in ensuring integrity in financial disclosures. As a global governance profession, Company Secretaries also need to lead themselves into active participation in the regeneration of global financial architecture that is on the anvil in the aftermath of the global financial crisis.

The UN General Assembly has already appointed a Commission of Experts for reforming the international monetary and financial system. Financial and monetary system of the world does need better and revamped regulation although the failed 'too-large-to-fail' banks and investment banks would resist extra regulation, feels Prof. Joseph E. Stiglitz, Chairman of the Commission of Experts. [Prof. Stiglitz is the Nobel Laureate in Economics] These banks are being bailed out by the respective governments with billions of dollars of tax payer money; yet, the banks have diverted the billions intended to enable them to revive lending to payments of outsized bonuses and dividends, points out Stiglitz [see the Economic Times of August 31, 2009].

An active understanding of the governance reforms in the global financial system has become a must for individual Company Secretaries and for the profession as a whole. We need to show corporate as well as collective professional leadership in the ongoing process of such regulatory reform. Great debates, for example, are taking place on the shape such reforms should take in the financial sector. One debate is whether such 'too-large-to-fail' banks have become 'too-large-to-manage' and therefore need to be split to avoid anti-competitive behaviour. Another debate, purely in India's context, is whether the Indian insurance regulatory authority should impose restrictions on pricing, on re-insurance and also compel mandatory coverage that forces insurers to write loss producing business and whether such restrictions would curtail attraction of the Indian insurance market to foreign insurers and also the growth of the Indian insurance market.

Transparency in disclosures need not take into account purely the past and the present. Non financial reporting, for example, Management Analysis and Discussion will take into account future economic predictions that will affect the future performance of the company even if that implies an incoming downturn, even if the past and the present profitability may have been exceedingly rosy. It is the Company Secretary who performs the task of drafting Management Analysis and Discussion. Good corporate governance demands that performance is sustainable and made sustainable. During boom times as the national and global economies are euphoric, the company might reap good performance and profits. Yet macro economic indices like savings having become negative as a proportion of disposable household incomes or home prices disproportionate to household incomes or rents, might require different policies and approaches to assure sustainability of corporate performance. Transparency demands sound disclosures in the board statements.

Global boom or prosperity like the one that ended into Great Recession in 2007, might have been generated due to global imbalances that are unsustainable. The economist Martin Wolf of the Financial Times, warned of the unsutainability of global imbalances. Economic theory and history have proved that rich countries had plentiful savings while poor ones had little. Capital flowed from the rich to the poor. But in the decade beginning 1997 poor China ran up enormous trade surpluses that financed enormous overconsumption in the richest economy, the US. This inversion of economic logic and history could not last forever. Wolf had pointed out that US consumers, not much long in the future, had to stop living beyond their means.

When the sharp fall in the US consumption came, deep recession resulted. The recession had been in the coming since 2005 affecting performance of the corporate sector that had benefited only externally from the continuous rises in the US consumption. Non financial disclosures should predict the effects and outline the corporate actions designed to mitigate negative effects. Projecting only the roses and excluding the thorns would make corporate statements exuberant but not transparent. Even during the boom times economist like Robert Shiller in his Irrational Exuberance had highlighted the unsustainability of the bubble predicting its inevitable burst. Company Secretary who would be a good member of the corporate leadership team would keep in the reading of such literature.

LEADERSHIP FOR CSE

Company Secretary is a man of governance; a man of ethics; and a man of creative compliance. Governance in the present century is integrating the erstwhile corporate philanthropy and the more advanced CSR and its next level Corporate Social Entrepreneurship (CSE) as an inalienable part of itself. Company Secretary has to show leadership so as to take on the newly developing CSE as an integral part of good governance. A great passionate organizational effort needs to go into making CSE as a good corporate habit. Building advanced and powerful relations with the members of the civil society, CSE will expand the core of corporate purpose and organizational values into society. CSE has to shape a fundamental change that will naturally create a feeling of being threatened and consequent resistance. This is because organizational skillsets are not yet developed in the area of social valueshaping. CSE requires disruptive social innovations. That creates discomfort. But for business to become sustainably successful it is necessary to provide values-based leadership that creates a synergy between economic and social values. That will involve tapping into the creativity of each individual and a release of enormous passion that is intrinsic.

Leading involves liberating positive passions among the team members to create and contribute to organizational purpose. Company Secretary who would cultivate leadership qualities as the corporate nucleus of communication knows how to emancipate people from barriers that stifle passion. Omar Khan and Paul B Brown of Sensei in their book Liberating Passion—How The World's Best Global Leaders Produce Winning Results have researched how organizations unwittingly chain the passion that is natural among people and baffle creativity and contribution that would otherwise gush forth with force. As I read through the book I thought I would share the thinking that discovers creative passion by simply keeping aside the obstacles that build up. As destined corporate leaders my professional colleagues would know how leaders produce great results through people.

Omar Khan and Paul B Brown define Passion to mean the voluntary will to engage completely the inner energy drive AND desire to deliver, to achieve, and to win.

Although much has been written and discussed about how to build passion, there seems to be a mistake. The presence of passion is natural. Its absence is what is profoundly unnatural.

The real problem is not how to build passion. The real problem is to understand how organizations kill it. Companies tend to become excessive passion killers. They are passion castrators in many ways.

Companies lack mentors. Without a mentor or a coach, people try to apply what worked in their last position. They don't gain new skills, aptitudes or different ways of thinking. If they happen to produce results, it is often by compensating for what they haven't developed. They get job done only dysfunctionally. Organizations often stunt collective learning. This creates a vacuum rather than a living culture. Though these unmentored and un-coached managers may cultivate a knack of producing some results, the opportunity cost, the human debris and the collective unfulfilled potential along the way can be devastating.

Leadership is fundamentally about how we relate to others, how we engage, mobilize, focus, and unite each other—or fail to.

In real life corporate scenario you always find a conflict between creative people and commercial (business) people. They are respectively called the right brain people and the left brain people. Business people look at the creatives as quirky and arrogant who fail to understand the realities of business. Creatives consider business people to be cynical and overbearing with no appreciation of the creative process. Organizations need innovation; they need creativity; they need to unlock value, as they are creators and deliverers of value. But they need to do so especially when a downturn is expected or when they find themselves in the midst of a crisis. Therefore leadership learns to strike a balance between the right brain functioning and left brain functioning within the organization. You need to create cross-functional teaming that fosters empathy between creatives and non-creatives. Leaders try to achieve this empathy especially during peace time. As they say, when you bleed more during peace time, you sweat less during war time. Khan and Brown prescribe the idea of radical conversation as a way to achieve synergy between the creatives and the commercials.

As Arie de Geus puts it, "managing for fundamental internal change is far less gratifying than managing for growth… perception to an individual is an active engagement with the outside world and in a company it is similarly active. Perception requires a deliberate effort by management groups within the company to 'visit their future' and develop time paths and options. Making this effort is easier for an individual human being than for a company, because the brain is hardwired to perform this sort of active engagement." [The Living Company, pg. 43 and 47]

We have to eliminate the division between who we are and what we do. We have to learn to convert leadership from a set of grand intentions into a wonderful way to engage and evoke the best in each other. We have to stop "educating passion out of people.

When we take a step back, we can see why passion killers abound and are so devastatingly omnipresent. In passion-killing events every (almost) undertaking is trivialized in to a set of technical actions, formats, formulae and injunctions. They are just not sufficient for summoning human capability, energy and imagination. It is only by grappling with this fundamental of barriers that we can get to the passion liberators that this book is really about. [Liberating Passion—by Omar Khan—Times Group Books] These passion liberators are interactions, behaviors and tools that can take us forward to the vision and culture we truly want. They energize our potential—which is ultimately what passion and so much of leadership are all about.

Passion killers remain in place, despite their evident destructive impact, because to confront them would require reengineering fundamental attitudes and beliefs that show up most evidently in relationships. There is a level and quality of conversational and relational leadership required to achieve and sustain change and improvement until it becomes truly integrated.

We need, first, to tell the truth early, openly and courageously. People speak of brutal honesty;

Khan feels honesty is the best tool to re-invent "what is" and to help each other really win. Secondly, we must consult early enough, when ideas are still in development, before there is excessive emotional attachment to them. Energy be spent on consultative co-creation rather than frenetic advocacy and after-the-fact critical cross-examination. Thirdly, empowering relationships requires asking the question whether "once our action is aligned, do we move fast from decision to action?" Fourthly powerful collaboration must make us more than the sum of our parts.

According to Khan the first passion liberator is intimacy. That means "into me see," an invitation to be known and an eagerness to get to know the colleagues. For, we are all a work in progress. And that is indeed "okay" as long as we can share that and work on it together.

A team that supports its members past defensiveness is a team that can as a result have more bracing, gustier, crucial conversations that can move the corporate performance powerfully forward. Intimacy tops the list of passion liberators and is the ultimate bedrock of empowering relationships. If one creates intimacy one gains a deep and authentic insight into the needs, challenges and strengths of those one works with and offers others a corresponding insight into oneself. We can appreciate and constructively challenge each other. Having recreated healthy relationships, we then will face the truth, improve ideas together, act with alignment, and become more together than we are apart. If we do that passion killers either won't form or will eliminate-- fast.

This requires an exercise: "sharing our masks". A "mask" is simply an appearance. When people don't know us, our mask is simply how we appear to them. We project and protect an image. We protect an aura of independence. It is very hard to get anyone to confess this. When masks are shared, it is possible to communicate without distortions and more from our authentic intent and selves.

For better communication to happen, it is necessary to have radical conversations among team members. A radical conversation is one that goes to the root of one or more of our issues, opportunities or challenges. This will help making it clear what and where the "bull's eye" lies. The foundations of good relationships become strong. The company progresses on the basis of the quality, audacity, depth, imagination, and the courage of its conversations.

In our education system, the test of intelligence is to win a debate and to find what's wrong in the other person's position. This is egotistically gratifying; but reinforces the dead-end as nothing moves forward. Creativity is finding a way not confirming a barrier.

The authors say that in fact it is "self-cannibalization that fosters creativity (not, self-aggrandization). You have to create the possibility focus and the provocative future. The authors give the example of Jack Welch who took the entrenched process of budgeting, for example, and improved how his team did it. He made it become a "swing for the fences" exercise and a way to allocate resources for breakthroughs. Budgeting did not remain a mere "negotiation" that landed the iterative "last year plus 10%" that is the bane of so many businesses. As a leader you have to remove the barriers to passion for work.

THE LIVING COMPANY

Achieving growth in turbulent times requires corporate leadership to accept "The Living Company" concept [read Arie de Geus, Nicholas Brealey Publishing]. The purpose of corporations to provide a financial return; or, the purpose to provide products and services making human life more comfortable and desirable; or, the purpose to provide for the public good: to create jobs and ensure a stable economic platform for all the stakeholders of society, all these purposes fade to backburner. "Like all organisms, the living company exists primarily for its own survival and improvement: to fulfill its potential and to become as great as it can be." The real purpose of a living company is to survive and thrive in the long run. It must be able to convert itself into an organization that accelerates learning and treats knowledge as a strategic asset.

Ashish Singh and David Sweig of Bain & Company have carried out studies that show that for surviving in turbulent times companies need to manage cash and liquidity aggressively. Companies need to use online information gearing derived from cash flow and liquidity management to gain forward visibility. This allows them a big advantage in facing headwinds.

During the times of crisis cash flows are harder than ever to generate. Even if companies are not battered by bankruptcies, they experience severe cash flow problems. But companies that manage cash flows and liquidity aggressively in anticipation of incoming turbulence retain a stable rate of growth through it, having built the ready financial muscle to face a downturn. Good examples of such strategy are the Wal-Mart and Pentaloon Retail while the bad examples are various airlines in India—AirIndia, Jet Airways and Kingfisher.

Wal-Mart aggressively managed resources to take advantage of weaknesses of others. The company cut capital expenditures, shelved a share buy back programme, and trimmed inventories. It shifted cash from opening new stores to remodeling existing ones. This allowed Wal-Mart to cut prices when downturn occurred retaining a stable growth in sales.

Pantaloon Retail in India, just a year before the downturn changed its business model by cutting costs, redeploying existing staff to new stores and outsourcing its IT function. It embellished its new conservatism by the slogan for its employees, "Say with pride, we are stingy". As the turbulence hit, its EBIDTA surged over 43 per cent. The tough October-December 2008 quarter pushed the turnover to Rs. 1.57 billion as it cut staff costs and rationalized administrative and selling costs. While its competitors struggled, Pentaloon continued to expand albeit at a slower pace.

Good leadership requires during turbulent times, point out Singh and Sweig, to show management teams how much cash they need to preserve and protect the business under the best forecast, the worst forecast and the median forecast. It becomes necessary to capture real-time information on what is flowing into and out of each business segment on a weekly and monthly basis. You need to compare these flows with budgets, big variances raising red flags in product lines, routes to the customers, and vendor relations. These can be addressed before it is too late.

Management understands how big changes in liquidity flow through to the profit and loss account will be generated. Leadership will also stimulate similar research on the cash flows of competitors, customers, and vendors. This way, companies can learn which competitors are vulnerable, which customers are strongest, and which vendors might not survive. Such research will produce enough reliable data enabling companies make better predictions and manage effectively through a sustained period of turbulence.

In 1970s the Royal Dutch/ Shell petroleum giant felt the severity of the oncoming oil crisis. Reserves of reasonably accessible oil were projected to last only three to four decades. Shell group had begun diversification into metals, nuclear power, chemicals and other businesses, but without much success. The Group carried out research and analysis of large companies older than Shell that had, during their history, successfully weathered fundamental change in the environment enabling them to survive with their corporate identity intact.

Arie de Geus points out that the long living large companies Shell identified had following four characteristics: (1) longlived companies were sensitive to their environment representing their ability to learn and adapt; (2) longlived companies were cohesive, with a strong sense identity that showed innate ability to build a community and a persona for itself; (3) longlived companies exhibited tolerance and its corollary, decentralization, showing the company's awareness of ecology: its ability to build constructive relationships with other entities within and outside itself; (4) [and this corresponds to what Singh and Sweig emphasize in The Economic Times of September 23, 2009] longlived companies are conservative in financing; are frugal not risking their capital gratuitously: showing the ability to govern own growth and evolution effectively.

Longliving companies will always, or at least, with regular periodicity, seriously tackle the futuristic perspective. This perspective planning or viewing will not only be from the limited corporate angle; futurosity will propel corporate leadership to go out into the wide world and look back at their company with the question to themselves: what relevance could the driving forces that we see externally bear for the more limited world of our company and industry? Peter Schwartz in his book The Art of Long View suggests that the budding futurist should learn to look at the fringes. Talk to people with whom you deeply disagree but can talk amicably. Read widely, ranging far outside your immediate business interest. Good leaders do that and are able to bring impossibly varied perspectives to the corporate businesses by embarking upon what is popularly called 'scenario planning'. 'Scenarios' are used as tools for foresight: discussions and documents whose purpose is not a prediction or a plan, but a change in the mindset of the people who use them. As Geus puts it "By telling stories about the future in the context of our own perceptions of the present, we open our eyes for developments which in the normal course of daily life are indeed 'unthinkable'. Relevant scenarios brought down to the level of the individual player, help the manager and his or her colleagues scout the lay of the land and see a wider scenery. Scenarios bring new views and ideas about the landscape into the heads of managers, and they help managers learn to recognize new, 'unthinkable' aspects of the landscape even after the scenario exercise is over". "Good scenarios change the microcosms of management" (Pierre Wack). [The Living Company pg. 59]

Corporate life, like individual life, may be far removed from the expected. A long enduring corporate life may be wilder than the widest that can be imagined. If the mindset of management is made strong and invincible, vast and uniquely calm, deeply immersed in wellness, incomparable in attitudinal richness, the corporate will sail through unimaginable scenarios erring on both sides and will become a longliving corporate.

But, take it from me, whether you like it or not, the required offtake from the 'urgent', mundane tasks of line managers is hard to come about. Line managers are emotionally involve in the present pressures of duty-bound performance. They look upon this 'flight' into futuristic perspective as an unwelcome intrusion in their work. The 'urgents' make them heavy-footed; they are lost in the marshes of overbearing responsibilities of the present. But the flight to the future and viewing the corporate existence from the 'outside-in' perspective are inescapable necessaries for a longliving corporation, albeit line managers tend to remain enmeshed in the thick mud of the mundane. The leadership has to take up this challenge as the greatest challenge and cultivate the good corporate habit to enslave itself to the 'other- world' perspective with willing eagerness. Wise scenario planning of the future must become an integral part of corporate planning process. The test of good governance leadership lies in impelling the line managers to 'think the unthinkable'. [Refer Kees van der Heijden's Scenarios: The Art of Strategic conversation and Art Kleiner's The Age of Heretics, Heroes, Outlaws and the Forerunners of Corporate Change pp. 162-3].

Scenario planning will make corporate managers to question their own assumptions and recharge the deep-lead mental maps about reality. Governance leadership must be able to substantively accelerate organizational learning. The normal and fateful assumption is that 'organisations do not learn, people do'. It rarely occurs to the management that company itself could do learning of its own. Good governance leadership must perceive and keep always in view the reality and vital possibility of corporate learning.

Organizational learning would not take place in the usual teaching and learning style, what educationists call as 'learning by assimilation'. In fact the teacher and the taught method, contrary to common belief, does not give rise to any learning. It amounts to merely stacking the minds and brains with probably irrelevant historical data. Learning, if at all is very slow and tends to antiquate itself as it takes place.

Organizational learning needs to be open, speedy, inventive and courageous. Educationist Piaget calls this as learning by accommodation [Jean Piaget, The Psychology of Intelligence]. When performance comes, you realize that teaching is an "ineffective route to learning". In learning by accommodation you undergo an internal structural change in your beliefs, ideas and attitudes. Such learning as an empirical process making you to adapt to changing world. In such learning the participation is full-fledged when you do not know what the final result will be, but you know that you will be different when you come out at the other end. You constantly interrelate with the environment. This makes the organization grow, survive and develop its own potential and potential of its people. Successful companies become successful because they are made by their leaders to learn by accommodation and they do so with remarkable continuity.

D. W. Winnicot from the British Tavistock Institute in his book Playing and Reality points out that the essence of learning is discovery through playing. A decision making process accelerates learning only by making skillful use of playing. To play is to learn. In a game you have to participate with all your heart, intellect, presence of mind, superlative adaptation to circumstances as they develop. Then only you may come out a winner. It should be like so to speak redesigning an aircraft while it is in flight with around 300 passengers on board. Even as a piece of imagination this makes you shudder. But organizations that become learning organizations do make environmental accommodation and navigation a vibrant habit. Constant assessment, diagnosis, accommodation and interaction with business environment as it develops are essential because they challenge the mental models that managers have developed enabling refreshening of mental perceptions and responses. The Fifth Discipline Fieldbook by Peter Senge gives the techniques to achieve defreezing managers' mental models to achieve organizational integration with the environment. That will lead to success in CSE (the theme of tomorrow) as well.

UNIQUE LEAD

In the context of passionate leadership style and the longliving company concept, to end, I also suggest we read through Maverick the autobiography of a business as well as a businessman, Ricardo Semler, Chairman of SEMCO, one of Brazil's largest conglomerates. It was first published in Brazil in 1988 as Turning the Tables which became the all-time best-selling nonfiction book in Brazil's history. Semler is the son of an entrepreneur who enters the family business and transforms it into a multi billion dollar business empire. What is unusual is the way he developed management, labour relations and the work environment to achieve these goals.

Among many 'radical' policies, Semler let his employees set their own hours, design their workplace, choose their own IT, share all information and have no secrets. Every six months bosses are evaluated by their subordinates and the results are posted. Semco has a policy of complete internal financial openness, even teaching factory workers how to read accounts so they can understand the company's books. Salaries are public information unless the employee requests they not be published. In addition, all employees can set their own salary. In doing so they must consider what they think they can make elsewhere; what others with similar skills and responsibilities make in the company; what friends with similar backgrounds make and how much they need to live on. Semco doesn't have receptionists, secretaries or personal assistants, regarding them as unnecessary.

Each business unit is small enough so that those involved understand everything that is going on and can influence the outcomes. Starting out as a manufacturing company, Semco allowed its workers to set their own production quotas and found that employees would voluntarily work overtime to meet them. Profit sharing is practiced right down to factory floor level, instead of large bonuses only for senior management. Semler eventually retired from all executive positions at age 33.

Rather than mere theory, Semler's ideas have all been tested in practice.

Semco seeks to streamline and simplify processes and avoid complicated manuals. For example, the Semco company manual in an appendix is a brief comic book!

Leadership, in order to be effective in producing good results in the long run, may or may not be as dramatic, yet miraculous as at Semco. Leadership is essentially innate and vigorous life-force. It creates life in life, good cheer even in calamities, restraint and rededication in boom times, all-round engineering in hard as well as soft matters. In crux, it is subtle and not gross although it may, sometimes, appear to be so. It hard-drives; and, yet, appears to be soft-peddling. It is, sometimes a sweet childlike arrogance. It creates followership making the followers feel that, in reality, they are in the saddle. All said and done, leadership is a unique gift to the mankind. It being thus and so, can Company Secretaries stop short of generating true corporate leadership on their own ?

Sub - Theme 1

Managing Growth in Turbulent Times

BOARD AS A STRATEGIC ASSET — COMPANY SECRETARY, THE CUSTODIAN

CS SUTANU SINHA*

Board is the Business Brain of a Company. Like biological constitution, it can not function at its own. It operates through its various well defined, synchronized and supportive organs. Naturally Board can not see, feel or sense itself. It is highly dependent on its various organs to perform. It depends highly on many factors like information, past experience, knowledge and above all the environment wherein it operate.

The Institute of Directors (IOD) Standardized Board's activities as under:

- Drive the organization forward while simultaneously exercising prudent control.
- Sufficiently knowledgeable to be answerable yet able to take an objective long-term view.
- Sensitive to short-term local issues and aware of broader trends and competition.
- Balance employer role and business interests with ethics and accountability to stakeholders.

In order to perform efficiently, the Board therefore should be a learning body. A learning Board ensures sustainable performance of a company. A Learning Board strives for:

Operational Learning : Learning of day-to-day operations to add further value towards organisational effectiveness

Policy Learning : Totally focused on Customer orientation

Strategic Learning : Driving the Company to achieve its mission.

For a learning Board, the customer is paramount. The Board is to ensure that the customer oriented business staff is properly empowered and day-to-day operations are self-managed by the management below the Board. There should be a strong feedback mechanism to help the Board learning from mistakes and gaining from successes. There should be a robust system of sharing of information and good practices.

The four basic ingredients of a Board functions can be mapped as under :

Board Foresight

— *Understanding the Purpose of the Company* : The objects of the Company should be clear and well defined. If required same should be re-aligned by changing object clause of the Company's memorandum

— *Creating Vision and Values to Meet the Purpose* : Successful businesses the world over are

* Director (Academics), The ICSI. The views expressed are personal views of the author and do not necessarily reflect those of the Institute.

driven by its vision and values. Board being the supreme strategic body formulates vision and practice values creation to meet the objective of business and stakeholders' expectations.

— *Establishing Corporate Environment and Culture* : In doing so, the Board links itself to the management entrusted to perform as per its strategies, plans and directions.

— *Understanding External Environment* : A sensitive Board is very much responsive to external factors like laws and regulations, geographical area of operations, overall economic environment, customer choice, taste and habits and so on so forth. A sensitive Board is expected to consider all these external factors in decision making process.

STRATEGY FORMULATION

— *Positioning the Company in the Changing Markets* : Business is a dynamic process and highly dependent on market conditions. It is one of the key aspects to be taken care of by the Board while formulating business strategies.

— *Setting Corporate Direction* : Board level directions being key to success of the business, they should be clear, un-ambiguous, focused and relevant.

— *Reviewing and Deciding key Resources* : Board level functions starts while a decision is taken and concludes with successful implementation by the management, its credibility can be ensured by putting in place an effective review and evaluation mechanism, as good governance practice.

— *Deciding Implementation Process* : When Board decides the process for implementation of its decisions in clear and unambiguous terms, it becomes easy for the management to perform as per its expectations. Periodical review, revaluation and re-engineering of processes under change management is also a sign of dynamic business process for the successful companies. Board as a supreme body, work as a facilitator to the management towards this direction.

SUPERVISION OF MANAGEMENT

— *Overseeing Management Performance* : The Board is to get proper and timely information through management system so as to be always kept apprised of the latest position. Implementation of such an overseeing mechanism either directly or through committees of the Board (like audit committee) is essential to ensure better supervision.

— *Monitoring Budgetary Control* : Translating planning into financial proposition and its monitoring periodically is one of the core functions of the Board.

— *Reviewing Key Business Results* : Review is a learning process through which outcomes are analyzed and new business strategies are formulated and directions are issued. It can be successful only when the complete information is provided for which a mechanism need to be developed.

— *Ensuring Organizational Capability* : Capability analysis and perspective planning for the company is one of the major function of the Board to ensure long term sustainability.

ACCOUNTABILITY

— *To the Company* : Board works as the Brain of the Company. Hence, Company always expects proper directions from the Board.

— *To Investors* : Board acts as de-facto trustee for the shareholders who expect Board to function in such a way so that company prospers and enhances intrinsic value of their investments.

— *To Regulators* : One of the fundamental duties of any corporate Board is to direct the company ethically and comply with all applicable laws. It becomes more challenging for companies operating in different jurisdictions the world over.

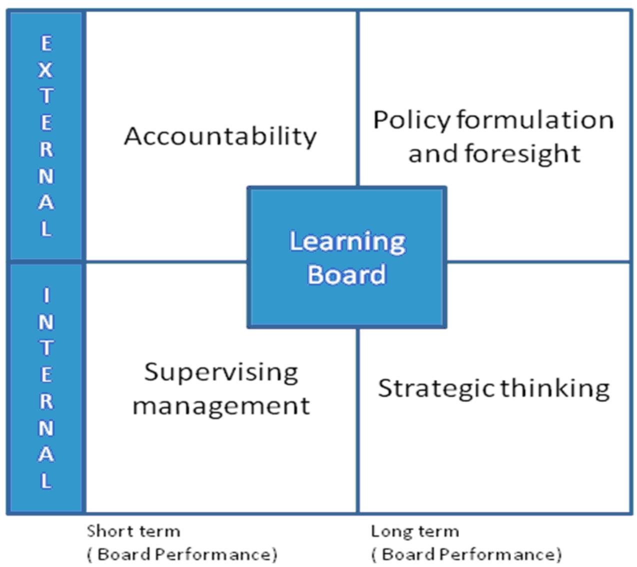
BACKGROUNDER

— *To Stakeholders* : As a corporate citizen, a company operates in a society and is bound to serve the society. The concept of Corporate Social Responsibility as an essential component of good corporate governance has almost emerged from this proposition.

— *Evaluation of Board Performance* : The emerging practice of evaluation of performance reviewing of Board as well as its members' is a strong quality assurance tool for Board functioning.

A learning Board can only function efficiently and effectively to achieve results by doing above functions. Bob Gerratte in his book `Fish Rots from the Head' suggested following Model for Learning Board :

The Simple Learning Board



(*Source* : Book "Fish Rots from the Head" by Bob Gerratt).

Functioning in both the areas -- short term as well as long term objectives of the Board is equally important. In UK under the Companies Act , 2006, legislature expects that Board members should act to bring success of the Company.

Now, pertinent question is, How the Board will learn and that the learning is a continuous process? The legal and regulatory framework of the country demands Board to conduct its meetings and thus, the Board learns through its meetings. That is however dependent on the quality of inputs provided to the Board members before the meeting through Agenda of the Meeting as well as by clarifying matters at the meeting .

AGENDA OF THE BOARD - A TOOL FOR SHARING AND LEARNING

Preparation of exhaustive and focused structured Agenda is an effective learning tool for the Board. Quality of the Agenda matters - it changes total gamut of decision making process of the Board. A good agenda can enlighten the Board to sub serve its purpose. Company Secretary can play a very important role in this direction. Rather than performing a role as a conduit to pass on proposals before the Board, he need to get involved in each and every proposal and add value, keeping in mind Company's mission and objectives as well as legal and environmental framework under which a Corporate operate.

CUSTOMER DRIVEN CULTURE BY THE BOARD – A STUDY

Jan Carlzon in the Book "Moments of Truth" identified how Scandinavian Air Service (SAS) oriented itself towards customers to build a customer driven organization. He identified following major aspects in this context :

(i) "The Board of SAS reoriented to become a customer driven company –a company that recognises that its only true assets are satisfied customers, all of whom expect to be treated as individuals, and who won't select SAS as their airline unless SAS do just that".

(ii) They identified that every year, each of ten million customers came in contact with approximately five SAS employees, and this contact lasted an average of 15 seconds each time. "The SAS is 'created' 50 million times a year, 15 seconds at a time. Those 50 million 'moments of truth' were the moments that ultimately determined whether SAS would succeed or fail as a company. Those were the moments when SAS was to prove to their customers that SAS was their best alternative".

(iii) In a customer-driven company, the distribution of the roles is radically different (than in a production or revenue-driven one). The organization is decentralized, with responsibility delegated to those who until then have comprised the order obeying bottom level of the pyramid. The traditional, hierarchical corporate structure, in other words, began to give way to a flattened and more horizontal structure. This is true in service businesses that begin not with the product but with the customer.

(iv) Running a business is not always a matter of logic and mathematics. It's just as much a question of understanding the psychological impact that a new and intriguing offer will make on the market.

(v) SAS communicated a vision of what the company could be, and they were willing to take the responsibility of making it work.

(vi) SAS decided to stop regarding expenses as an evil which they should minimize, and to begin looking at them as resources for improving their competitiveness. Expenses could, in fact, give them a competitive edge if they contributed to the goal of serving the Customers. They identified that there was no guarantee that those additional expenses would bring in more revenue. But SAS Board took the risk.

(vii) SAS Board learned "Mistakes can usually be corrected later; the time that is lost in not making a decision can never be retrieved".

(viii) As soon as Board approved, SAS distributed a little red book entitled 'lets get in there and fight' to all 20,000 employees. This gave staff, in very concise terms, the information about the companies' vision and goals that the Board and top management already had. They wanted everyone in the company to understand the goal. "The new energy at SAS was as a result of the 20,000 employees all striving towards single goal (common purpose) every day".

(ix) They learned that "A leader is not appointed because he knows everything and can make every decision. He is appointed to bring together the knowledge that is available and then create the prerequisites for the work to be done."

(x) "By defining clear goals and strategies, and then communicating them to SAS employees and training them to take responsibility for reaching these goals, the leader can create a secure working environment that fosters flexibility and innovation". "Thus the new leader is a listener, communicator, and educator - an emotionally expressive and inspiring person who can create the right atmosphere rather that makes all the decisions himself".

BACKGROUNDER

(xi) "In many respects though, the leader has to be an enlightened dictator - one who is willing to disseminate the vision and the goals throughout a large, decentralised organization, but who will not brook active dissent to the underlying ideas. He must be able to present his vision convincingly so that the goals and strategies feel right to everyone in the company".

(xii) "In changing a business environment, one can't wield total control from the top of the pyramid. One must give people authority far out on the line where the action is. They are the ones who can sense the changes in the market. By giving them security, authority and the right to make decisions based on current market conditions. Organization can put itself in the best position to gain a competitive edge".

(xiii) Company can determine goals and strategies only if it has clear idea of the environment where it is working in, or of what its customers want ?.

(xiv) Business planning based on a sound perception of "customers wants and needs" sounds very easy, but for those sitting at the top of the pyramid - and not working on the front-line, in day-to-day contact with the customers - it can be tricky.

(xv) In stark contrast to the production orientated company, where decisions are motivated by product and technology considerations, the customer orientated company begins with the market, and lets it guide every decision, every investment, and every change.

(xvi) Upon receiving broad overall objectives for achieving company goals, middle management first breaks them down into a series of smaller objectives that the front line people will be able to accomplish. At that point the role of middle management is transformed from administration to support.

(xvii) "Unfortunately most front line employees have been following regulations for so long that few have the courage to try something new". This is a challenge to any organization which wants to become learning organization.

(xviii) "Leaders and managers must give guidance, not punishment, to employees who take risks and, occasionally, make mistakes. Wrong decisions should be used as a basis for training; right decisions should be used as the basis for praise and positive examples. The right to make mistakes is not equivalent to the right to be incompetent, especially not as a manager".

(xix) In a decentralized, customer-driven company, a good leader spends more time communicating than doing anything else. He must communicate with the employees to keep them all working towards the same goal, and he must communicate with his customers to keep abreast of the companies new activities and services.

(xx) "Only the customer, and the customer alone, will pay costs and provide profits".

SAS Board has also formulated a new strategy for sustainability work with clearly defined goals and activities. Their aim was to be in the forefront in the airline industry. As a first step on the road to the vision of zero emissions, they determined to reduce greenhouse gas emissions by 20 percent by 2020 regardless of traffic growth.

SAS study clearly shows that any Board to perform needs to identify all the moments of truth that its front line people face when it reach customers or consumers. If a company can develop a strong mechanism to identify those moments of truth, it can excel. It can excel because it becomes a learning organization with a focused motive and common purpose. In SAS study, it is revealed that how Board as a Body can play the leadership role towards accomplishing its goals.

The heart of the Learning Board is understanding the distinction between management and the governance.

WHAT HAPPENS IF BOARD IS NOT A LEARNING BOARD ?

— There would be tendency to hide mistakes,

— It may pass on accountability and blame others,

— It becomes non-committed,

— It would avoid responsibility, and

— Fosters a negative culture.

ROLE OF COMPANY SECRETARY

Company Secretary is the only officer of the Company in addition to the MD or Whole Time Directors who interacts with the Board regularly and acts as custodian to the Board. The preceding discussion on functions of the Board definitely highlights that holding minimum number of Board meetings or conducting those meeting according to law are only statutory functions. The real challenge lies in how to conduct effective Board meetings where a lot of intellectual value is to be added to the corporate system of a Company. It is one of the key role of a Company Secretary to foster that culture.

The New Companies Bill, 2009 introduced before the Parliament of India has very prominently recognized the role of Company Secretary as a Key Managerial Person (KMP).

Success of the company is dependent on how a company Board functions and how Company Secretary being the facilitator to the Board provides value added information to help Board in decision making process. In the context of good governance, every effort should be made to add further value beyond the compliances of various laws and regulations applicable to a particular company. In this regard, the role of Company Secretary mapped on four basic ingredients of Board functions, as under:

Board Foresight : Scrutinizing and reviewing all the activities of the company from the perspective of corporate vision and values. Company secretary being a permanent person more close to Board can guide and advise the Board towards establishing good corporate environment and culture. Most of the globally successful companies have translated its values and strategies through various policy statements, say, on employees, environment, CSR, sustainability and of course on corporate governance. It is the duty of Company Secretary to bring out these type of policy documents through Board so that company is totally focused on its mission.

To function efficiently, Board is also be informed about entire business perspective as well as functions of the competitors or associate companies in particular. It is the duty of the management to keep posted the Board of directors with all such information and here, Company Secretary should play the role of a coordinator for providing such knowledge information to the Board.

Strategy Formulation : In any corporate, Company Secretary is such a person who by default come to know about entire business operations of the company and constitutes a holistic perspective about the company. The knowledge he gains can be utilized for assisting the Board towards formulation of corporate strategies, making decisions, as well as implementation and review of such decisions. Standardization of Board processes is therefore very important for a company which can be made through adoption of Secretarial Standards and also by formulating industry specific standards for a company. Adoption of globally accepted standards like ISO, SA-8000, Sustainability Standards, etc. can also help the company to implement a robust system wherein Board and the management can work in total synchronization towards achieving its goals.

Supervision of Management : The major function of Company Secretary is to coordinate between the Board and the management. A Board is to direct and the management is to perform. Thus, the role of a Company Secretary in this aspect sometimes becomes very critical and as professional one should be clear minded and discourage Board not to enter into management functions which may lead to governance crisis. However, at the same time, management is supposed to provide regular feedback to the Board in respect of various directions given by the Board from time to time. Further, assessment of organizational capability is a joint function of the management and the Board of directors of the company. This includes assessment of company, its management as also the Board of Directors which is the most precious asset of the company.

Accountability : As a governance professional, the Company Secretary is entrusted to ensure that interest of all the stakeholders like investors, regulators, legislators, employees, other associate companies and the society at large is protected. It is also the duty of the Company Secretary to ensure that the company has established a good corporate communication system towards disseminating information to the various stakeholders. One of the major corporate function is corporate compliance and Company Secretary should ensure that there is a proper corporate compliance management system so that Board can concentrate and dedicate its valuable time on business issues rather than spending time on peripheral issues.

The role profile of Company Secretary is diversifying fast with emergence of new dynamic corporate paradigm which expected them not only to see their role confined to Board room, but to look upon it from a larger perspective of custodian of the Board as a strategic asset.

MANAGING GROWTH IN TURBULENT TIMES

V P SHARMA*

CURRENT GLOBAL OUTLOOK

The global economic outlook deteriorated sharply over the last quarters. In a sign of the ferocity of the down turn, the IMF marked down, yet again, its estimate for global growth in 2009 to a range of (-) 1.0 to (-) 0.5 per cent, the first global contraction in 60 years. With all the advanced economies – the United States, Europe and Japan - having firmly gone into recession, the contagion of the crisis from the financial sector to the real sector has been unforgiving and total. Recent evidence suggests that contractionary forces are strong: demand has slumped, production is plunging, job losses are rising and credit markets remain in seizure. Most worryingly, world trade – the main channel through which the downturn will get transmitted on the way forward – is projected to contract by 2.8 per cent in 2009, the fastest pace of shrinkage in the last 80 years.

GLOBAL FINANCIAL CRISIS

According to the Webster dictionary, a crisis is defined as "an unstable or crucial time in which a decisive change is impending, especially one with the distinct possibility of a highly undesirable outcome". The global financial crisis is the culmination of an exceptional boom in credit growth and leverage in the financial system. Since the onset of 2009, almost everywhere, production has declined rapidly, world trade has virtually collapsed, and the recession has spread to all major economic regions.

Low interest rates, abundant liquidity, and low volatility prompted investors to search for higher yields without an adequate appreciation of related risks. Financial institutions developed new structures and innovative risky instruments to meet investors' demand for higher yields. Investors in turn, overly optimistic about continued rise in asset prices, did not look closely enough into the nature of the assets they bought. They mostly relied on the analysis of credit rating agencies which were, in some cases, also selling advice on how to develop the rated products. This failure of market discipline played a considerable role in the crisis.

Misplaced incentives, such as compensation systems based on short-term sale targets, helped boost excessive risk taking and profit expectations of investment banks. In addition, loose monetary conditions and global imbalances, which contributed to the large capital inflows to Europe and the United States, also fuelled the crisis. Cheap money encouraged leverage that boosted asset prices, which in turn encouraged further leverage. At the same time, the financial turmoil revealed shortcomings in firms' risk management practices and deficiencies in regulatory frameworks.

The financial system, being knocked by turbulent shocks, reacted by restricting economic activity through several channels, most notably by limiting the availability of credit. The strains in financial markets have also led to a sharp drop in equity prices. Capital losses on corporate equities, combined

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with further losses in real estate due to continued falling home prices, have considerably reduced household net worth, consequently restraining consumer spending. At the same time, the world economy entered a cooler cyclical phase at the end of last year, after a long and robust period of expansion. The global economic slump has deepened since then and spread to every region of the world.

Impact of Global Financial Crisis

On March 16, 2008: Bear Stearns was acquired for 2 dollars a share against its 52-week high of 134 dollars a share. July 14, 2008: Oil hits 145 dollars a barrel and then collapses to 34 dollars within six months. September 15, 2008: Collapse of Lehman Brothers. November 20,2008: Dow Jones at a record low of 7449 points. June 1, 2009: General Motors files for bankruptcy and later Satyam computers fraud. Basically, we are living in a time that has seen unprecedented volatility. From boom to bust in a matter of months, it was barely two years ago that the global economy was on a bull run that looked like it would never end. Asset prices were on a continuous upswing. In October 2007, the Dow Jones braced the 14000-mark. Everyone wanted to join the party. But distant winds have a way of moving in faster than imagine. Less than a year later, the collapse of several leading financial institutions caused a global chain effect that has shaken governments, investors and the common public alike.

The profound impact of this has since been felt deeply in the real economy. The total expected write-downs on global exposures are now estimated at about $4 trillion. World output is projected to decline by 1.3% in 2009. The International Monetary Fund (IMF) estimates the decline to be as sharp as 6.2% in Japan, 5.6% in Germany, 4.1% in UK and 2.8% in the US. The social cost of the downturn in many of these economies around the world has been particularly devastating. The rising numbers of those who have lost their jobs, homes and pension savings is leading to public anger. Questions are being asked about leadership and regulation.

Financial Crisis and Emerging Economies

The current global economic crisis was initially thought to be a financial problem exclusively affecting rich countries. As a result, the contagion to emerging Asia came as a surprise for a number of analysts and governments. A major reason why East Asian economies were expected to stay immune is because they had deeply reformed their financial systems in the wake of the so-called Asian crisis which was unfolded a decade earlier.

Emerging economies like China and India have also experienced the impact of the global slowdown and global credit shock. Growth in larger emerging economies is expected to slow to below recent strong rates, and the risk of contagion leading to much sharper contraction in smaller emerging economies has increased significantly. Those emerging markets with large current account deficits and external financing are particularly vulnerable. Analysts believe that prospects for 2010 and 2011 are highly uncertain with a broad range of possible outcomes for emerging markets, both individually and as a group.

Impact on China

China is the fastest emerging economy of the world. Earlier, it was also thought that China is protected from the vagaries of international capital flows because of its low involvement in financial globalization and the persistence of capital controls. By late 2008, however, two factors began to quickly undermine these assumptions. The first factor was the flight to safety in capital markets which led to sharp capital flow reversals and the second was the impact of the rapid decline in international trade volumes.

In China, economic growth began to fall sharply in the second half of 2008; by the end of the year, growth had collapsed from 2007- based projections of 13 percent for the year to 6.8 percent year-on year, with national output virtually stationary in the last quarter. After a protracted period of strong economic growth (close to three decades at 9 percent per annum), China entered a zone of turbulence, starting in the last quarter of 2008. These difficulties were further compounded by home-made problems. Before the global crisis spread to China, the country was faced with the risk of inflation and overheating, as a result Chinese authorities had engaged in a set of contractionary policies in the first half of 2008. But the abrupt slowdown in the last quarter of 2008 prompted them to suddenly backtrack and embark on a loose monetary policy and a multi-billion fiscal stimulus package aimed at lifting the economy out of the slump and putting it back on a strong growth path.

STATE OF INDIAN ECONOMY

The Indian economy over the last five years clocked an unprecedented 9% growth rate driven largely by domestic consumption and investment even as the share of the net export has been rising. This was not by chance. The benign global environment, easy liquidity and low interest rates helped, but at the hearts of India's growth were a growth of entrepreneurial spirit, rise in productivity and increasing savings. This fundamental strength continues to be in place. Nevertheless, the global crisis made a dent in India's growth trajectory as investments and export slowed. However, once the global economy begins to recover and there are signs of recovery, India's turnaround will be sharper and swifter, backed by strong fundamentals and the untapped growth potential. An estimated growth of GDP during the current financial year is around 6.5 per cent. This is because of effective strategies by Government and corporate to overcome recession and sustain at least existing rate of growth of GDP, the Indian economy has started showing the recovery.

IMPACT ON INDIA

India is one of the fastest emerging economies of the world.While the crisis began with the US housing market, the ferocity and speed with which it has spread around the world and even into India has surprised everyone. This has effectively debunked the myth that economies like India are delinked from the developed economies. The belief that India would continue to grow at the same rates irrespective of what happens elsewhere in the world seems misplaced in hindsight. As Dr. D Subbarao, Governor RBI pointed out in one of his speech: "Contrary to the 'decoupling hypothesis,' emerging economies too have been hit by the crisis . . . In a rapidly globalizing world, the 'decoupling hypothesis' was never totally persuasive."

The impact of the crisis has spread to India through all the channels – the financial channel, the real channel, and importantly, as happens in all financial crises, the confidence channel.

FINANCIAL MARKETS

India's financial markets - equity market, money market, forex market and credit market - had all come under pressure from a number of directions. As a consequence of the global liquidity squeeze, Indian corporates found their overseas financing drying up, forcing corporates to shift their credit demand to the domestic banking sector. Also, in their search for substitute financing, corporates withdrew their investments in domestic money market mutual funds (MFs);consequently, non-banking financial companies (NBFCs) where the MFs had invested a significant portion of their funds came under redemption pressure. This substitution of overseas financing by domestic financing brought both money markets and credit markets under pressure.

The forex market came under pressure because of reversal of capital flows as part of the global deleveraging process. Simultaneously, corporates were converting the funds raised locally into foreign currency to meet their external obligations. Both these factors put downward pressure on the rupee. The Reserve Bank's intervention in the forex market to manage the volatility in the rupee further added to liquidity tightening.

REAL CHANNEL

The transmission of the global cues to the domestic economy has been quite straight forward – through the slump in demand for exports. The United States, European Union and the Middle East, which account for three quarters of India's goods and services trade, are in a synchronized down turn. Services export growth is also likely to slow in the near term as the recession deepens and financial services firms – traditionally large users of outsourcing services – are restructured. Remittances from migrant workers too are likely to slow as the Middle East adjusts to lower crude prices and advanced economies go into a recession .There was also fall in FDIs and other foreign investments . IT and IT enabled sector was also adversely effected.

Confidence Channels

Beyond the financial and real channels of transmission as above, the crisis also spread through the confidence channel. In sharp contrast to global financial markets, which went into a seizure on account of a crisis of confidence, Indian financial markets continued to function in an orderly manner. Furthermore, Indian banks continued to lend. However, the tightened global liquidity situation in the period immediately following the Lehman failure in mid-September 2008, increased the risk aversion of the financial system and made some banks cautious about lending. The purport of the above explanation is to show how, despite not being part of the global financial sector problem; India has been affected by the crisis through the adverse feedback loops between external shocks and domestic vulnerabilities.

MANAGING GROWTH IN TURBULENT TIMES

The current public debate largely focuses on the origins of the crisis, yet it is time to look forward to address the question, as to how can businesses survive the crisis, and position themselves for the recovery whenever it may come?

Policy making around the world is in clearly uncharted territory. Governments and central banks across countries have responded to the crisis through big, aggressive and unconventional measures. There is a contentious debate on whether these measures are adequate and appropriate, and when, if at all, they will start to show results. There has also been a debate on, how abandoning the rule book, driven by the tyranny of the short-term, is compromising medium-term sustainability? What is clearly beyond debate though is that this Great Recession of 2008/09 is going to be deeper and the recovery would be longer than earlier thought.

The global financial crisis has created a structural break in the global economy. Businesses thus need to reassess the strategies they have developed to operate in a highly integrated global economy. Initial reactions have often been defensive as companies downsize and call for government support. However, times of crisis are also times of opportunity. In the short-term, opportunities arise for instance in 'value for money' segments. Long term opportunities require managers to develop foresight to use the crisis to position them for the next upswing. Business leaders thus need to develop scenarios of the new economy, and envisage their role in the process. Thus, Governments , Monetary institutions, Regulator bodies , International Forums and Corporates are required to design their strategies and policies in the light of prevalent economic and financial environment.

A. Response from the Governments and Central Banks

1. *Monetary Policy*

   All countries advanced or developing face a similar challenge of recession and followed necessary actions through monetary policy to overcome the situation of crisis. Immediate monetary easing could help ameliorate the downturn, helping restart the flow of credit in the economy. But monetary authorities have different room for manoeuvre. Past monetary policy co-ordination has proved effective, helping reduce the risk of excessive exchange rate volatility. This remains a policy option but should not undermine Central Bank independence or constrain those countries with more room for manoeuvre. The measures that governments and central banks have taken– including government guarantees of bank borrowing, special measures to provide liquidity to banks, and agreed frameworks for injection of capital to shore up institutions – to restore confidence and improve liquidity in the inter-bank market are now beginning to be effective in reducing interbank lending rates. However, in some countries it may be necessary to take additional measures to ensure the proper functioning of the monetary transmission mechanism – and in particular that reductions in policy rates translate into reductions in the rates charged to companies and households.

The Reserve Bank of India has multiple instruments at its command such as repo and reverse repo rates; cash reserve ratio (CRR), statutory liquidity ratio (SLR), open market operations, including the market stabilisation scheme (MSS) and the LAF, special market operations, and sector specific liquidity facilities. In addition, the Reserve Bank also uses prudential tools to modulate flow of credit to certain sectors consistent with financial stability. The availability of multiple instruments and flexible use of these instruments in the implementation of monetary policy has enabled the Reserve Bank to modulate the liquidity and interest rate conditions amidst uncertain global macroeconomic conditions.

The thrust of policy initiatives by the Reserve Bank has been on providing ample rupee liquidity, ensuring comfortable dollar liquidity and maintaining a market environment conducive for the continued flow of credit to productive sectors.

The Reserve Bank's policy response was aimed at containing the contagion from the outside - to keep the domestic money and credit markets functioning normally and see that the liquidity stress did not trigger solvency cascades. In particular, RBI targeted three objectives: first, to maintain a comfortable rupee liquidity position; second, to augment foreign exchange liquidity; and third, to maintain a policy framework that would keep credit delivery on track so as to arrest the moderation in growth. This marked a reversal of Reserve Bank's policy stance from monetary tightening in response to heightened inflationary pressures of the previous period to monetary easing in response to easing inflationary pressures and moderation in growth in the current cycle. RBI measures to meet the above objectives came in several policy packages starting mid-September 2008, in response to unanticipated global developments, and in anticipation of the impact of potential global developments on the Indian markets.

RBI policy packages included, like in the case of other central banks, both conventional and unconventional measures. On the conventional side, RBI reduced the policy interest rates aggressively and rapidly, reduced the quantum of bank reserves impounded by the central bank and expanded and liberalized the refinance facilities for export credit. Measures aimed at managing forex liquidity included an upward adjustment of the interest rate ceiling on the foreign currency deposits by non-resident Indians, substantially relaxing the external commercial borrowings (ECB) regime for corporates,and allowing non-banking financial companies and housing finance companies access to foreign borrowing.

The important among the many unconventional measures taken by the Reserve Bank of India are a rupee-dollar swap facility for Indian banks to give them comfort in managing their short-term foreign funding requirements, an exclusive refinance window as also a special purpose vehicle for supporting non-banking financial companies, and expanding the lendable resources available to apex finance institutions for refinancing credit extended to small industries, housing and exports. Reflecting the rapid turn of events that could impair assets down the line, we reversed the counter - cyclical regulatory measures introduced in 2006.

2. *Fiscal policy*

Fiscal policy also has an essential role to play alongside monetary policy in sustaining demand, with quick-acting measures to encourage a rapid impact with help for households and businesses. In a normal downturn, it would be expected that monetary policy would support demand, with fiscal policy playing a more limited supporting role. But in current circumstances, monetary policy alone will not be sufficient. The nature of the financial crisis, with credit constraints becoming more binding, and the effectiveness of monetary policy becoming more uncertain,also points to more of a fiscal response. Overall, a fiscal stimulus will be most effective if it is timely, so it delivers a stimulus when it is needed. Discretionary fiscal actions can take time to agree and implement, and can therefore become pro-cyclical, supporting growth when the economy is already recovering. While the likely duration of the current slowdown makes this less of an issue, the rate with which the world economy is slowing down means that rapid action is called for. So measures that can be introduced quickly are at a premium.

On the fiscal side, the government of India used emergency provisions in the Fiscal Responsibility and Budget Management Act to offer stimulus packages in December 2008 and January 2009 (amounting to 3% of GDP). The stimulus includes funding guarantees for infrastructure, indirect tax cuts and support to exporters. (The government also offered farm loan waiver package and social safety nets like the rural employment guarantee programme to insulate the poor.) The implementation of Sixth Pay Commission also contributed to revive the economy from economic crisis.

B. Response from International Institutions

The International institutions also took various initiatives to help member countries to overcome the economic crisis. The IMF has worked fast to lend to countries in crisis. The IMF has so far committed about $ 50 billion in lending to number of economies affected by the crisis. However, while 82% of its newly loaned resources have gone to European area countries, just 1.6% have gone to countries in Africa. This analysis confirms the World Bank's concern that IMF resources are likely to be devoted to high-income emerging markets and middle income countries. Much stronger efforts need to be made to engage major emerging and developing countries in a way which would achieve the G20 aspiration of an IMF which is more informed and effective and more responsive to the needs of the poorest countries. The World Bank's contribution to managing the crisis is being achieved with very few additional resources (in spite of G20 rhetoric). Instead the Bank is repackaging its existing IBRD and IDA loans.

Unlike the multilateral institutions, the European Union (EU) has made several pledges which repackage existing commitments as a response to the crisis. The EU and its member states should consider how to use resources, capacity to make quick political decisions, and potential to deliver aid fast, so as to fill the serious gaps in crisis-response by the G20, the IMF, and the World Bank. The EU could ensure rapid disbursement to countries whose investments in meeting the Millennium Development Goals are now at risk due to an external shock - the financial crisis - entirely outside their reckoning and control. The EU is also well-placed to ensure that appropriate regulatory arrangements are put in place, and reforms of global institutions are undertaken so as best to reduce future such crises.

C. Response from G-20

The G20 countries promises new resources , a reaffirmations of existing aid pledges , $ 50 billion to support social protection , boost trade and safeguard development in low income countries , a significant increase in crisis support in developing countries and more resources for social protection for the poorest countries . It has proven to be an effective forum for agenda –setting in response to the crisis.

Recently, the leaders of Group of 20 Industrialized and emerging Countries in a Summit in Pittsburg on 25th September 2009 agreed to continue strengthening regulation of the international financial system; protect consumers, depositors, and investors from abusive market practices; and encourage the resumption of lending to households and businesses. They asked the IMF to help the G-20 with its analysis of how national or regional policy frameworks fit together. At the same time, they stressed their commitment to the world's poorest countries, saying "steps to reduce the development gap can be a potent driver of global growth."

IMF Managing Director Dominique Strauss-Kahn welcomed the G-20's continuing support of the IMF and noted the leaders' reaffirmation of their London Summit initiative to reach agreement on IMF quotas by January 2011. According to Strauss-Kahn, "The April 2008 quota and voice reforms were a first step to enhance the voice and representation of the world's emerging and developing countries. Today's G-20's commitment to a shift in quota share to dynamic emerging market and developing countries of at least five percent from over-represented to under-represented countries, and to protect the voting share of the poorest in the IMF, is a decisive move. This historic decision, and the emergence of the G-20 as a key forum for international economic cooperation, will lay the foundation for a deeper partnership in global economic policy between emerging and developing countries and the advanced economies."

The collective response to the crisis has highlighted both the benefits of international cooperation and the need for a more legitimate and effective IMF. The Fund must play a critical role in promoting global financial stability and rebalancing growth.

D. Response from Corporate

Some of the major strategies the corporate may follow to overcome recession and global financial crisis include the following:

(i) *Focus strategies* : Focus strategies are best fit with the current crisis. This is because companies need to minimize the risks (the differentiation strategies will not help in this because innovation is extremely associated with high risk). In addition, cutting costs strategies will not be a good solution if these weren't used wisely(companies will think about cutting costs as firing employees with high salaries who usually the most educated and have the experience). On the other hand, see the financial crisis as an opportunity rather than a threat. Companies need to focus on specific profitable areas and have enough resources to do so. Focus strategies if used according to deep studies and understanding of the market segmentation and the associated risks, will allow the companies to utilize their resources wisely, reduce the risk and gain profit.

(ii) *Improvement in Liquidity Position* : Improve corporate liquidity position by enhancing the inflow of cash and restructure the organization. Take all the possible measures to sustain the cash balance of the company and cut short the expenses. Strong liquidity base will give a new life to the company.

(iii) *Exploring New Sources of Income* : There is need for the companies to search for new sources of income. A regular inflow of cash is essential to sustain any business. Search for new corporate clients and sustain the existing clients.

(iv) *Immunity to Business* : It is essential for the companies to bring immunity to business for a long term survival and growth.

(v) *Increasing transparency* : The lack of market price transparency in structured credit instruments has exacerbated the accounting and valuation challenges created by—and contributing to—this crisis. Improvements in the public availability of price and trading information would aid in price discovery and market price valuation. In addition, banks need to be given appropriate regulatory incentives to consolidate off-balance sheet entities when they are likely in practice, to stand behind them.

(vi) *Promoting due diligence*: Institutional investors especially need to adopt investment guidelines that require greater due diligence as their fund managers move into new asset classes. To improve scrutiny, structured credit products need to become simpler and easier for investors to value independently.

(vii) *Fostering market liquidity* : Liquidity and in turn the price discovery process, in over-the-counter markets has proved fragile. Steps are needed to bolster the dependability of liquidity in these markets—for instance, through formalizing dealer's quote obligations (as in the U.S. treasury market).

(viii) *Ensuring Good Corporate Governance Practices* : The global financial crisis has led many economic and financial market participants to re-examine their governance practices, and standards. The Financial Crisis Advisory Group (the "FCAG") was formed to advise the International Accounting Standards Board (the "IASB") and the US Financial Accounting Standards Board (the "FASB") about the standard setting implications of the financial crisis and potential changes in the global regulatory environment. The Advisory Group in its discussions recognized the critical role that general purpose financial reporting ("financial reporting") plays in the financial system and identified four principles that financial reporting must meet if it is to fulfil this role well. These principles are as follows:

1. Effective Financial Reporting: Financial reporting plays an integral role in the financial system by striving to provide unbiased, transparent and relevant information about the economic performance and condition of businesses. Effective financial reporting depends on high quality accounting standards as well as the consistent and faithful application and rigorous independent audit and enforcement of those standards.

   Financial reporting is of great importance to investors and other financial market participants in their resource allocation decisions and to regulators and other users. The confidence of all these users in the transparency and integrity of financial reporting is critically important to global financial stability and sound economic growth. Where regulatory standards differ from accounting standards in ways that could have significant effects on financial reporting, the effects of those differences should be disclosed in a manner that does not compromise the transparency and integrity of financial reporting.

2. Limitations of Financial Reporting: Although effective financial reporting provides indispensable rigor and transparency to the market, investors, analysts, regulators and others cannot rely exclusively on the information it provides. All users should recognize the limitations of financial reporting: it provides only a snapshot in time of economic performance and cannot provide perfect insight into the effects of macro-economic developments. Financial reporting is also dependent on the generation of reliable data by well-functioning markets that have proper infrastructure, and the use by financial institutions and other business entities of proper processes for price verification and other aspects of the valuation of assets and liabilities.

3. Convergence of Accounting Standards: Because of the global nature of the financial markets, it is critically important to achieve a single set of high quality, globally converged financial reporting standards that provide consistent, unbiased, transparent and relevant information, regardless of the geographical location of the reporting entity.

4. Standard Setter Independence and Accountability: To develop standards that are high quality and unbiased, accounting standard setters must enjoy a high degree of independence from undue commercial and political pressures, but they must also have a high degree of accountability through appropriate due process, including wide engagement with stakeholders, and oversight conducted in the public interest.

The Advisory Group reviewed the governance practices, and standards of the Boards that are most relevant to the financial crisis in the light of these principles and formulated recommendations accordingly.

CONCLUSION

Albert Einstein once remarked, "In the middle of every difficulty lies opportunity." He also said, "The definition of insanity is doing the same thing over and over again and expecting different results. This crisis is no different because it presents us with tremendous opportunities. The opportunity to still remain focused on a growth agenda while significantly transforming our cost structures. At a time of crisis more than any other it is ultimately leadership that matters. Today, the role of leadership in business has come under ever more scrutiny. In the end, winning over the long haul demands a deep seated belief in principles and values that are non-negotiable. That is the moral underpinning of a successful enterprise. As Peter Drucker said "For it is character through which leadership is exercised, it is character that sets the example and is imitated in turn … what will be decisive above all, in the future even more than in the past, is neither education nor skill; it is integrity of character."

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CHANGING DEMOGRAPHIC PROFILE OF INDIAN CAPITAL MARKETS

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INTRODUCTION

Today, one of the engines driving the remarkable growth in India is its large class of talented private entrepreneurs. After a few tentative flutters in the early 1990s, they are now showing their true worth as many indigenous start-ups are becoming global success stories. Indian business has done unexpectedly well in the last decade and a half – largely as a result of more efficient use of resources, men and machines. Today, many Indian brands are creating their own space in minds and markets abroad. As Indian companies compete with the world - across industry, manufacturing and the services spectrum - Indian companies are spreading out to the foreign shores.

Globalisation has indeed fuelled this growth of Indian businesses. Indian corporates continue to invest in acquisitions and joint ventures to gain global presence and increase revenues, add new assets, diversify product portfolio, and exploit the potential of new markets. Indian companies have improved their visibility in global markets by finalising 1270 M&A deals in 2009 till date. Recently, there have been a slew of big-ticket global acquisitions made by Indian companies, across myriad of sectors and geographies.

Top 10 billion dollar mergers and acquisitions by Indian companies :

1. Tata Steel's mega takeover of European steel major Corus for $12.2 billion. The biggest ever for an Indian company. This is the first big thing which marked the arrival of India Inc on the global stage.
2. Hindalco of Aditya Birla group's acquisition of Novellis for $6 billion.
3. ONGC acquisition of Russia based Imperial Energy for $2.8 billion. This marked the turn around of India's hunt for natural reserves to compete with China.
4. Tata Motors acquisition of luxury car maker Jaguar Land Rover for $2.3 billion.
5. Wind Energy premier Suzlon Energy's acquisition of RePower for $1.7 billion.

The strategic imperatives that have contributed to the globalisation of the Indian businesses and rapid emergence on the global M&A horizon can be attributed to the raising of permissible investment limits, streamlining of processes and positive changes in policy guidelines. While these factors have undoubtedly fuelled Indian MNCs' drive to invest overseas, the rise of entrepreneurial ambitions and the aspirations of Indian companies to seamlessly grow have together been the driving forces behind the unparalleled overseas expansion of Indian companies.

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THE INDIAN CAPITAL MARKET

Matching the cross border expansion of Indian Companies, the Indian Capital Markets have also grown exponentially in the last few years. The growth has been in every sphere - the amount of capital raised through primary issuances, exchange trading turnovers, the market indices and market capitalization, mutual fund assets, access to foreign markets for raising funds, foreign listing and foreign institutional investment. In fact, none of this would have been possible if the Indian markets had not developed a world class market and regulatory infrastructure. The efforts of the last decade in developing an efficient market infrastructure have created a market that has made transactions transparent and settlements safer. The Indian Capital Market has come a long way from trading under the Banyan tree to internet trading. Let us look at the evolution of Indian Capital Market.

Evolution of Indian Capital Market

The history of the capital market in India dates back to the eighteenth century when East India Company securities were traded in the country. The securities trading, till the end of nineteenth century, was unorganized and Bombay and Calcutta were the major trading centres. During 1860-61, Bombay being an important source of supply for cotton, the trading activities flourished resulting in a boom in share prices - the first in the history of the Indian capital market. The boom lasted for five years, when the bubble burst in 1865, with tremendous slump in share prices. At that time trading was limited to only a dozen brokers and the trading was conducted under a banyan tree in front of the Town Hall in Bombay. In 1875, stockbrokers formed Native Shares and Stock Brokers Association, Bombay and subsequently the Bombay Stock Exchange was recognized in May 1927 under the Bombay Securities Contracts Control Act, 1925.

The size of the capital market remained small in the Post-independence period and the Controller of Capital Issues (CCI) closely supervised and controlled the timing, composition, interest rates, pricing, allotment, and floatation costs of new issues. The enactment of the Securities Contracts (Regulation) Act in 1956 was characterized by the establishment of a network for the development of financial institutions and state financial corporations. In 1964, the Unit Trust of India (UTI) came into existence. In 1969, 'Badla' which provided a mechanism for carrying forward positions as well as borrowing funds was abolished. The badla trading was again resumed in July 1974, when the government promulgated the Dividend Restriction Ordinance. This led to a slump in market capitalization at the BSE by about 20 per cent overnight and the stock market remained closed for nearly a fortnight. The buoyancy returned to stock markets when the multinational companies (MNCs) were forced to dilute their majority stocks in their Indian ventures in favour of the Indian public under FERA, 1973. One hundred and twenty-three MNCs offered shares at lower than their intrinsic worth. Hence, for the first time, the FERA dilution created an equity cult in India. Many investors got an opportunity to invest in the stocks of such MNCs.

The 1980s witnessed an explosive growth of the securities market in India, with millions of investors suddenly discovering lucrative opportunities. Many investors jumped into the stock markets for the first time. The government's liberalization process initiated during the mid-1980s, spurred this growth. Participation by small investors, speculation, defaults, ban on badla, and resumption of badla continued. Convertible debentures emerged as a popular instrument of resource mobilization in the primary market. The introduction of public sector bonds and the successful mega issues of Private Sector Companies gave a new lease of life to the primary market. This, in turn, enlarged volumes in the secondary market. The decade of the 1980s was also characterized by an increase in the number of stock exchanges, listed companies, paid up-capital, and market capitalization.

The 1990s was the most important decade in the history of the capital market of India. The Government announced new industrial policy and coined new term-Liberalisation and globalization.

The Capital Issues (Control) Act, 1947 was repealed in May 1992. The decade was also witnessed establishment of SEBI as a new capital market regulator, advent of foreign institutional investors, euro-issues, free pricing, new trading practices, new stock exchanges, entry of new players such as private sector mutual funds and private sector banks.

In 1992 the then-member-owned Bombay Stock Exchange (BSE) traded for only two hours a day with an open outcry system. The market capitalization of the 6,480 companies listed on the BSE on March 31, 1992, was Rs.3,541.87 billion (US$144.6 billion), which was Rs.5,876107 crore on October 15, 2009.

Technological innovation was largely propelled by the National Stock Exchange (NSE), a demutualized electronic exchange incorporated in November 1992 by major public sector financial institutions. It introduced a modern market infrastructure with fully-automated, screen-based trading systems and settlement systems benchmarked with the world. The Indian capital market entered the twenty-first century with discontinuation of badla from July 2001 and introduction of rolling settlement in all scrips. Internet trading was permitted in February 2000. Trading of futures commenced from June 2000, In 2003, the government's decision to privatize oil PSUs in 2003 fuelled stock prices and Foreign institutional investors emerged as major players on the Indian bourses.

The systems put in place by NSE and BSE, created more efficient, liquid, and transparent stock exchanges, and were instrumental in minimizing market systemic and settlement risks. By mid-2007, 99.9 percent of trades settled in dematerialized form in a rolling T+2 environment.

Now the capital market is well organized, fairly integrated, mature, modernized and demographically well diversified. The Indian equity market is one of the best in the world in terms of technology. Advances in computer and communications technology, coming together on Internet are shattering geographic boundaries and enlarging the investor class across the national boundaries.

A More Dynamic Capital Market

The market has been transformed in the seventeen years since SEBI emerged as the statutory regulator of India's securities market. India's market in 2009 features a developed regulatory environment, a modern market infrastructure, a steadily increasing market capitalization and liquidity, better allocation and mobilization of resources, a rapidly developing derivatives market, a robust mutual fund industry, and increased issuer transparency. A brief description of market structure and characteristics is given below :

Market Characteristics

	1992	*2007*	*2009*
Market Capitalisation ($billion)	144.6	987.2	995.64
Number of registered foreign institutional investors	0	987	1403
Number of mutual funds	6	38	41
Number of demat accounts	0	6362845	6223524

Changing Demographic Profile of Investors in India

The expansion of India's middle class continue to drive the growth of the Indian capital market. A report by the McKinsey Global Institute predicts that India's middle class (and thus the pool of potential Indian investors) would expand dramatically over the next two decades. The report suggests that if

India continues its recent growth, average household income will triple over the next two decades, and the country will become the world's fifth largest consumer economy by 2025. In the process, the report says, "almost 300 million people will move out of desperate poverty and India's middle class will balloon from 50 million people to almost 600 million."

Recently Max New York Life Insurance Company Limited and the National Council of Applied Economic Research (NCAER) conducted a study on 'How India Earns, Spends and Saves (2008)'. The findings of the study are—

— A financially secure country cannot be built on the base of a small proportion of financially secure households

— India saves but does not invest. India saves for long-term goals such as emergencies, education and old age, but does not invest in long-term instruments. Financial vulnerability is not limited to poor households; even prosperous households are financially vulnerable as … a majority … do not plan their future, nor do they save long-term

— Less than 25 per cent of households have life insurance

Indian households – wise savers but unwise investors

— 81% of Indians save; the average household savings are Rs.16,139

— The top income-quintile saves 44% of income

— Graduate households save 30% of income

— Non-graduate families an average of 18%

— Salaried earners save around 7% of income

— Labourer households save about 4%.

Expansion of Indian Public Issues

The Indian public issue market has witnessed highs and lows several times over the last three decades. During the beginning of the current decade, it saw a frenzy surrounding the I.T. Sector. The year 2002-03 witnessed only 6 public issues. The market witnessed a resurgence in 2003-04 with 28 public issues raising the highest-ever amount of Rs.17807 crore. The trend continued in 2004-05; though it witnessed only 29 issues, the amount raised was higher than the previous year at Rs.21432 crore. In the subsequent year 2005-06, as many as 102 companies entered the market raising an even higher Rs.23676 crore. Though 2006-07 saw a fall in the number of issues, the amount raised was a record Rs.24993 crore. Moving forward, 2007-08 witnessed the highest ever mobilization of Rs.52219 core, which was more than double of the amount raised in the previous year. Rights issues have almost followed a similar trend.

(Rs.crore)

	Public Issues (Equity & Convertibles)		*Rights Issues (Equity & Convertibles)*		*Total Issues (Equity & Convertibles)*	
	No.	*Amount (cr.)*	*No.*	*Amount (Cr.)*	*No.*	*Amount(Cr.)*
1995-1996	1402	8723	291	6520	1693	15242
1996-1997	684	4372	131	2724	815	7097
1997-1998	58	1132	49	1703	107	2835

	Public Issues (Equity & Convertibles)		Rights Issues (Equity & Convertibles)		Total Issues (Equity & Convertibles)	
	No.	Amount (cr.)	No.	Amount (Cr.)	No.	Amount(Cr.)
1998-1999	22	504	26	568	48	1072
1999-2000	56	2975	28	1560	84	4535
2000-2001	110	2380	27	729	137	3109
2001-2002	6	1082	13	1041	19	2123
2002-2003	6	1039	12	431	18	1470
2003-2004	28	17807	22	1006	50	18813
2004-2005	29	21432	26	3616	55	25047
2005-2006	102	23676	36	4126	138	27802
2006-2007	85	24993	38	3704	123	28697
2007-2008	90	52219	30	32518	120	84737
2008-2009	21	2034	23	12622	44	14656

(Source – The Prime Directory 2009)

Expanding Profile of Foreign investors

Reflecting India's improving macroeconomic fundamentals, increasing corporate profitability and competitiveness, and greater integration with the world economy, foreign institutional investors' (FIIs) participation grew steadily over the years. The inflow of portfolio capital continues to test new highs and in recent years has outpaced the inflow of foreign direct investment (FDI). Greater inflows may be expected, due to international investors' quest for higher returns and improved portfolio diversification, backed by ongoing structural changes in India's economy and its financial markets. Sustained inflow of capital will not only bring greater liquidity in the market, but further expand the demographic profile of investors. A fact sheet on FDI equity inflow for 1991-2009 is given below :

FACT SHEET ON FOREIGN DIRECT INVESTMENT (FDI)

CUMULATIVE FDI EQUITY INFLOWS (1991-2009) (equity capital components only)

1.	Cumulative amount of FDI inflows *(from August 1991 to July 2009)*	Rs. 5,04,793 crore	US$ 117,032 million

FDI EQUITY INFLOWS (WITH COMPANY - WISE DETAILS) AVAILABLE 2000-2009

1.	Cumulative amount of FDI inflows *(from April 2000 to March 2009)*	Rs. 3,93,126 crore	US$ 89,840 million
2.	Amount of FDI inflows during 2009-10 *(from April 2009 to July 2009)*	Rs. 51,062 crore	US$ 10,492 million
3.	Cumulative amount of FDI inflows *(updated up to July 2009)*	Rs. 4,44,188 crore	US$ 100,332 million

Note : FDI inflows include amount received on account of advances pending for issue of shares for the years 1999 to 2004.

BACKGROUNDER

FDI EQUITY INFLOWS DURING FINANCIAL YEAR 2009-10

Financial Year 2009-10 (April-March)		*Amount of FDI inflows**	
		(In Rs. Crore)	*(In US$ mn)*
1.	April 2009	11,708	2,339
2.	May 2009	10,168	2,095
3.	June 2009	12,335	2,582
4.	July 2009	16,852	3,476
2009-10 (Up to July 2009)		51,063	10,492
2008-09 (Up to July 2008)		51,440	12,320
%age growth over last year		(-) 0.70%	(-)15%

FDI EQUITY INFLOWS DURING CALENDAR YEAR 2009

Calendar Year 2009 (Jan.-Dec.)	*Amount of FDI inflows**	
	(In Rs. Crore)	*(In US$ mn)*
1. January 2009	13,347	2,733
2. February 2009	7,223	1,466
3. March 2009	10,023	1,956
4. April 2009	11,708	2,339
5. May 2009	10,168	2,095
6. June 2009	12,335	2,582
7. July 2009	16,852	3,476
Year 2009 (up to July 2009)	81,656	16,647
Year 2008 (up to July 2008)	98,861	24,201
%age growth over last year	(-) 17 %	(-) 31 %

Significant Participation of Foreign Institutional Investors

The changes in market structure, regulation and technology brought about significant qualitative changes in the Indian securities market, greatly reduced systemic and settlement risks, and helped create more transparent, liquid and efficient securities markets. Increasing confidence in the fairness and efficiency of the market, and the elimination of barriers to foreign institutional investment in 1994, fueled the growth of foreign portfolio investment. Portfolio Investment by Foreign Institutional Investors (FIIs) in India has grown every year since then, except for 1998, when the Asian crisis led to a major exodus across all markets.

The FII investment was initially limited to a selected group of stocks and they were excluded from the growing market for bonds, and government securities. Their entry into the latter was permitted only in the late 1990s. The total amount of funds raised by India through GDR constituted roughly 40 percent of total inflows. However, during the second half of the 1990s there was a sharp decline in the funds raised through GDR and FII investment in the Indian equity (and recently bond market) became the main form of portfolio inflows. Thus in a span of less than a decade, private foreign investment to India constitute more than 55 per cent of all flows. The total inflow of $ 22 billion as portfolio investment also constitutes a significant proportion of the total market capitalization in India.

Capital Flows into India after 1990's (US $ million)

Year	*FDI*	*FPI*	*FII*	*NRI*	*GDR/ ADR*	*Offshore funds and Others*
1990-91	97	6	-	-	-	-
1991-92	129	4	-	-	-	-
1992-93	315	244	1	42	240	-
1993-94	586	3567	1665	89	1520	-
1994-95	1314	3824	1503	171	2082	-
1995-96	2144	2748	2009	169	683	56
1996-97	2821	3312	1926	135	1366	20
1997-98	3557	1828	979	202	645	204
1998-99	2462	-61	-390	179	270	59
1999-00	2155	3026	2135	171	768	123
2000-01	4029	2760	1847	67	831	82
2001-02	6130	2021	1505	35	477	39
2002-03	5035	979	377	NA	600	2
2003-04	4322	11377	10918	NA	459	-
2004-05	6051	9315	8686	NA	613	16
2005-06	8961	12494	9926	NA	2552	14
2006-07	22079	7062	3225	NA	3776	2
2007-08	32435	29395	20328	NA	8769	298

The steady and continuing flow of investments from foreign and domestic institutional investors had boosted India's market indices to record levels. During the period April – September 2007, FIIs had invested nearly US$11.5 billion as compared to US$6.7 billion in the whole of 2006-2007. The flow of foreign funds into the Indian capital market is one of several indicators of the strength and outlook for continuing market development and expanding demographic profile of investors in India.

India, which is the second fastest growing economy after China, has lately been a major recipient of foreign institutional investor (FII) funds driven by the strong fundamentals and growth opportunities.

According to analysts, the late revival of monsoon, upward revision of economic growth from 5.8 per cent to 6.1 per cent, better-than-expected performance of companies in the quarter ended-June 30, the new direct taxes code, leading to savings in the tax payer's money, and the trade policy with an ambitious target of US$ 200 billion exports for 2010-11 have all revived the confidence of FIIs investing in India. Both consumption and investment-led industries linked to domestic demand, such as auto, banking, capital goods, infrastructure and retail, are likely to continue attracting FII funds.

FIIs have made net investments of US$ 10 billion in the first six months (April to September) of 2009-10. Major portion of these investments have come through the primary market, more than through buying via secondary markets. Earlier, FIIs' net investments in Indian equities crossed the US$ 8 billion-mark in 2009, the first time in this year, with foreigners buying stocks worth US$ 274 million on August 28, 2009. With FIIs holding 16 per cent of India's biggest 500 companies and increasing growth of the economy, the FII sentiment is expected to remain positive towards India. At the end of July 2009, net inflows from FIIs stood at US$ 7.3 billion.

A report of Ernst and Young says that Private equity (PE) and venture capital (VC) investments increased nearly 10 times from US$ 30 million in 2006 to US$ 300 million by 2008. It further said that PE / VC players had invested US$ 527 million in the construction sector—24 per cent of the total transaction value in India for the period January 2005 and July 21, 2009.

Strengthened Connections to Global Markets

Recent investments in Indian exchanges as well as plans to develop an International Financial Center in India strengthen the connections with global markets. Recent alliances with foreign stock exchanges bring to India's capital market the extensive resources, experience, and networks of some of the world's preeminent financial market groups, that are strongly positioned in North America, Europe, and Asia. They will significantly strengthen India's stock exchanges and its capital market. Because the development of technology to run trading platforms is one of the largest expenses of an exchange, this relationship would also help in continually upgrading and maintaining technological superiority at a lower cost than otherwise.

CHALLENGES AHEAD

Development of Corporate Bond Market

A well-developed bond market helps ensure efficient allocation of resources and could act as a buffer against sudden interruptions in bank credit and international capital flows. A corporate bond market would also improve the efficiency and stability of the financial system and the economy's growth.

The Planning Commission of India has estimated that investments in varied infrastructures will be in the order of Rs.1,450,000 crore (or US$320 billion) during its eleventh five-year plan (2007–08 to 2011–12). In terms of a percentage of GDP, this would require almost doubling infrastructure investment from 4.6 percent to 8 percent during the plan period. The Indian corporate bond market can play a significant role in supplying the infrastructure to support economic growth. Therefore, enhancing investors' and issuers' willingness and ability to utilize the corporate bond market would increase financial diversification and make it easier to obtain necessary financing to benefit companies at all levels of the ratings scale, as well as developers of infrastructure.

The recent World Bank report that analyzed India's bond market pointed out that "As infrastructure policy and regulatory frameworks emerge and reforms advance, a better developed financial system, particularly a long–term domestic bond market, can accelerate access to finance by infrastructure projects."

In India today, corporate debt capital is raised through private placements and international issues. Corporate debt instruments are predominantly simple fixed-rate coupons. There are very few innovative instruments or derivative or hedging devices that would help investors protect against credit risk. The World Bank report found that "a comparison of the size and composition of the domestic debt market in India and seven other prominent emerging market countries puts India ahead of only Mexico in the size of its corporate bond market."

Investor Education and Awareness

While the Indian markets have made spectacular progress in the last few years, various studies and surveys suggest that the presence of the retail Indian investor is still limited. This is, the studies suggest, because they are constrained by the inability to come to grips with concepts of market risks and returns, and the inability to accept market investment as a tool for promoting long-term savings and wealth creation.

Investors express extreme reactions to distasteful market events. A major reason for this lack of investor confidence in the markets is a widespread lack of understanding of the workings of capital market, by investors. Various studies/surveys indicate towards the need for financial literacy, i.e., investor awareness and education to ensure that investors are cognizant, conscious, awake, alert, watchful and vigilant to make informed investment decisions, understand nuances in capital market terminologies, his rights and obligations and the grievance redressal mechanisms.

Initiatives for financial literacy in India

Ministry of Corporate Affairs has taken various initiatives to educate investors, particularly, since 2001, the Investor Education and Protection Fund (IEPF) has been working for educating the investors and for creating greater awareness about investments in the corporate sector. So far, it has more than 60 NGOs/Voluntary Organizations registered, and funded. Besides interactive worships with NGOs/ Voluntary Organizations (VOs), "Training the Trainers" programmes, Investor Helpline have been funded under the Investor Education and Protection Fund window. The MCA also launched the IEPF website www.iepf.gov.in for dissemination of information.

SEBI has also launched a comprehensive securities market awareness campaign for educating investors through workshops, audio-visual clippings, distribution of educative investor materials/booklets, dedicated investor website etc. It has also recognized certain investor associations through which the investor is educated.

RBI has advised State Level Bankers' Committee convener banks to set-up, on a pilot basis, a financial literacy-cum-counseling centre in any one district, and based on the experience gained, to ask the concerned lead banks to set-up centres in other districts. It has also undertaken a project on financial literacy by asking banks to introduce comic books explaining terms like inflation, how to open an account, interest rates, etc.

In this regard it is felt that road map for financial literacy of small investors be drawn on the lines of the five year plans for national development need to be developed. Improving the financial literacy of investors is a task that could be undertaken through public-private partnerships. Successful partnerships can efficiently reach key audiences with high-quality, unbiased information. NGOs/Educational Organizations can play a pro-active role in investors' education by keeping them posted of knowledge in respect of their rights and obligations as well as about the capital market, its various segments and corporate. Professional institutions should also be involved actively to educate the investors through their networks spread across the country.

Need for Financial Literacy in Schools

It is apparent from the preceding discussion that the initiatives towards financial education by RBI and financial institutions are primarily focused on financial market and banking system. Similarly, the financial education including capital market is mainly imparted to students for XI and XII standard, who opt the stream as per their career options. While the students in other stream such as Science and Humanities do not get financial education at all. Moreover, students up to Class X do not get any type of financial education. Even at the College level the students are not provided the financial education except for Commerce stream. In this background and based on the studies conducted on the subject, a need is felt to introduce financial literacy at school and college levels.

CONCLUSION

India's economy is expected to benefit enormously from the process of gradual capital market liberalization. Empirical evidence shows that emerging market economies that have vigorously pursued reforms in financial markets experienced higher growth and investment. India is no exception with rise in per capita GDP, domestic and foreign investment and still expanding profile of investors. Drawing from these experiences India's growth potential can be sustained on long-term basis with continued reforms in capital markets.

In an environment marked by growing numbers of businesses operating in multiple countries, and rising levels of capital moving across borders, there is a need for common benchmark standards to promote the delivery of reliable, consistent, and comparable information. While regulatory and policy decisions in all countries must, of course, fit within national legal frameworks, yet the decisions affecting global business, global investment, and global markets, need greater international cooperation and collaboration rather than stand-alone national approaches.

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CREATIVE CORPORATE DESTRUCTION — A CASE STUDY UNDER UNITED STATES BANKRUPTCY CODE

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"Every piece of business strategy acquires its true significance only against the background of that process and within the situation created by it. It must be seen in its role in the perennial gale of creative destruction." – *Joseph Schumpeter*

INTRODUCTION

American bankruptcy procedures enable sick Companies to restructure its debt obligations even while remaining operational. In this context, one must recognise that in the US the well known Chapter 11 bankruptcy proceedings are considered as re-organization/ resurrection process for corporates. Many companies are known to have revived from them. Further, Chapter 11 ensures the emergence of companies with sustainable debt levels and profitable working.

One of the most remarkable events in recent business history has been the decision of General Motors Corporation USA to file bankruptcy proceedings — a decision forced on the company after it lost market share in the ongoing recession. Its assets were significantly lower than its liabilities. It has emerged from 40 days bankruptcy protection after creating a "new GM" made up of the best assets with fewer brand, fewer employees etc. For that matter, Chapter 11 could even recover WorldCom which emerged from bankruptcy as MCI during 2004. It is nothing wrong to refer Chapter 11, a regulatory magic stick that converts a sick company into a successful company which results in Creative Corporate Destruction. This article is an attempt to highlight the mechanism of Chapter 11 with the help of case studies.

CREATIVE DESTRUCTION

'Capitalism, Socialism and Democracy' a famous book by Joseph Schumpeter deals with creative destruction. In Schumpeter's view, socialism will ensure that the production of goods and services is directed towards meeting the 'authentic needs' of people. He used the term 'creative destruction' to describe innovative entry by entrepreneurs as the force that sustained long-term economic growth, even as it destroyed the value of established companies that enjoyed some degree of monopoly power.

Creative destruction is fostered by advances in technology and the opportunities that entrepreneurs see to profit from such advances. It can operate at different speeds in different countries and regions as a result of differences in cost structures, government policies, consumer tastes, etc. The Creative destruction can be exemplified as main frame computers to personal computers, manual clock to electronic clock etc.

CREATIVE DESTRUCTION- SCOPE OF THE CONCEPT

— The concept of creative destruction fits well with a contemporary social, especially global world that is dynamic, changing and competitive. It is a social process or a social change and, as such, fits well in a world that is in continual process and undergoing constant change. Such a world

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needs to be analyzed dynamically and a dynamic concept like creative destruction is perfect for such a world.

— Creative destruction was designed to analyze business-related economic developments, in the contemporary world.

— While creative destruction was developed in an economic context and Schumpeter had a broader multidisciplinary perspective that encompassed not only the economic, but also the social and the cultural dimensions.

CREATIVE CORPORATE DESTRUCTION – US BANKRUPTCY CODE

Bankruptcies in the US

Bankruptcy is a legal procedure designed to protect both an individual or business that can't meet its financial obligations and to protect the creditors involved. The 10 largest bankruptcies in the United States since 1980, are as under

— Lehman Brothers Holdings Inc(2008)

— Washington Mutual(2008)

— WorldCom Inc.(2002)

— General Motors Corp.(2009)

— Enron Corp.(2001)

— Conseco Inc (2002)

— Chrysler LLC(2009)

— Thornburg Mortgara Inc (2009)

— Pacific Gas and Electric Co (2001)

— Texaco Inc (1987)

Chapter 11 of US Bankruptcy Code

Section 363 under Chapter 11 of US Bankruptcy law is an established procedure which enables companies to sell assets free of debts and encumbrances to preserve the value of the enterprise. A company under Chapter 11 can choose to sell off particular assets. A bankrupt company, the "debtor," might use this Code to "reorganize" its business and become profitable again.

There are four possible outcomes in most Chapter 11 Bankruptcy cases : dismissal, conversion to Chapter 7, liquidation by sale in Chapter 11, and confirmation of a plan of reorganization. The fourth outcome i.e. approval of the reorganization plan helps the bankrupt company to emerge as a successful corporate. By destroying the sick company, it leads a successful company to emerge. Here everything depends on the re-organisation plan filed by the Company.

The key to a successful Chapter 11 case is the continued operation of the debtor's business. In addition to running the business, the debtor or the trustee must fulfill additional duties required by the Bankruptcy Code and work with creditors, the court, and other parties to obtain financing for ongoing business operations.

Salient Features of Chapter 11

— Chapter 11 is not a declaration of insolvency.

— Companies don't file Chapter 11 to liquidate; they do so in order to continue operating and to take the necessary steps to emerge as a financially stronger business, reorganizing their operations or balance sheet or in some cases by selling substantially all its assets.

— Management remains in control of the business during the chapter 11 rehabilitative process. Trustees, administrators and monitors typically are not appointed.

— Chapter 11 normally does not cause interruption to business operations.

— The company is given breathing room during the process - an "automatic stay" generally prevents parties from taking legal action against the company or taking the company's assets.

— Most publicly-held companies prefer to file under Chapter 11 rather than Chapter 7 because they can still run their business and control the bankruptcy process. Chapter 11 provides a process for rehabilitating the business of the company.

Sometimes the company successfully works out a plan to return to profitability; sometimes, in the end, it liquidates. Under Chapter 11 reorganization, a company usually keeps doing business and its stock and bonds may continue to trade in securities markets.

The U.S. Trustee, the bankruptcy arm of the Justice Department, appoints one or more committees to represent the interests of creditors and stockholders in working with the company to develop a plan of reorganization to enable it to get out of debt. The plan must be accepted by the creditors, bondholders, and stockholders, and confirmed by the court. However, even if creditors or stockholders vote aginst the plan, the court can disregard the vote and still confirm the plan if it finds that the plan treats creditors and stockholders fairly.

Committees of creditors and stockholders negotiate a plan with the company to relieve the company from repaying part of its debt so that the company is able to get back to its normal condition.

After the committees work with the company to develop a plan, the bankruptcy court must find that it legally complies with the Bankruptcy Code before the plan can be implemented.

SUCCESS STORIES UNDER CHAPTER 11

General Motors Company (GM)

GM, one of the world's largest automakers, traces its roots back to 1908. It has its global headquarters in Detroit. It employs about 235,000 people in every major region of the world and operates in about 140 countries. GM and its strategic partners produce, sell and service cars and trucks in 34 countries under the brands such as Buick, Cadillac, Chevrolet, GMC, GM Daewoo, Holden, Opel, Vauxhall and Wuling. GM's largest national market is the United States, followed by China, Brazil, the United Kingdom, Canada, Russia and Germany.

The Fall and Recovery of General Motors – Time lines

July, 2008	-	GM announces plans to cut costs by $10 billion and raise $5 billion through borrowing and asset sales.
Sept., 2008	-	GM and Chrysler holds talks on merger
Dec., 2008	-	GM seeks U.S. government aid of up to $18 billion.
		GM and Chrysler granted $17.4 billion in government loans.
January, 2009	-	Toyota Motor Corp surpasses GM as the world's largest automaker for the first time.
February, 2009	-	GM announces plan to slash its global salaried workforce.
		GM raises U.S. funding request to a total of $30 billion, announces plans to cut global workforce by 47,000 and closed five U.S. plants by 2012.
		GM post losses of $30.9 billion for 2008.
March, 2009	-	GM was given 60 days to develop new restructuring plan.
April, 2009	-	GM offers final plan to reorganize outside bankruptcy by slashing bond debt, cutting over 21,000 more U.S. jobs and emerging as a nationalized automaker.
May, 2009	-	GM issued up to 60 billion new shares in a bid to pay off debt to the U.S. government, bondholders and the United Auto Workers (UAW).

		GM post a first-quarter net loss of $6 billion and a cash burn of $10.2 billion.
		GM borrowed another $4 billion from the U.S. Treasury and reaches deal with Canadian auto workers.
		GM and the U.S. Treasury made new equity exchange offer under which bondholders offered 10 percent of a reorganized company and given warrants to purchase another 15 percent.
June 1, 2009	**-**	**GM files for Chapter 11 bankruptcy protection at the U.S. Bankruptcy Court in the Southern District of New York.**
June 5, 2009	-	GM reaches a preliminary agreement to sell its Saturn brand to Penske Automotive Group.
June 25, 2009	-	Receives final court approval to borrow up to $33.3 billion from the U.S., Canadian and Ontario governments.
July 6, 2009	-	A U.S. judge approves GM's bankruptcy sale in a move to allow the company's most profitable assets to exit bankruptcy protection under government ownership. Indian Operations of GM kept outside the purview of Bankruptcy under Chapter XI.
July 10, 2009	**-**	**Emerges from bankruptcy protection after the 40-day bankruptcy which was concluded with a deal allowing GM to sell key operations and core brands, including Chevrolet and Cadillac, to a new company, in which majority is owned by the U.S. Treasury.**

OBSERVATIONS

GM emerged from its bankruptcy in 40 days by selling most of its healthy assets, namely the four brands which are slated to survive (Chevrolet, GMC, Buick and Cadillac), in a bankruptcy-court approved deal to its new ownership, which includes the U.S. and Canadian governments, the UAW and bondholders who held its unsecured debt.

OLD GM VS. NEW GM – A FACT SHEET

Particulars	*General Motors Corporation - Old GM*	*General Motors Company- Newly emerged GM after recovery*
Financials	Total obligations were more by $40 billion	The new GM has U.S. debt of about $11 billion, which excludes preferred stock of $9 billion
Ownership	A publicly traded company	The U.S. Treasury owns 60.8 percent of the new GM, the VEBA healthcare trust has a 17.5 percent stake, and Canada and Ontario governments 11.7 percent. The remaining 10 percent goes to the old GM to pay off unsecured creditors
Brands	Saab, Hummer and Saturn remained in the old company and are in the process of being sold.	The new GM is built on four core brands which account for more than 80 percent of the automaker's sales: Chevrolet, Cadillac, GMC and Buick.

Worldcom

Bernard Ebbers was well known for transforming a small Mississippi based company into one of the largest global players in telecommunications industry. Ebbers resorted to series of mergers and acquisitions taking over 60 companies in all, to build his empire. All these transactions were financed by highly valued Worldcom stocks and the booming stock market.

Bernard Ebber was neither qualified nor experienced to lead a telecom giant. He was a base ball coach who bought a Long Distance Discount Service (LDDS) during 1983 and made it big through series of acquisitions. In 1985 after the acquisition of voice and data transmission company, it changed its name to Worldcom. In 2000 SEC halt Worldcom's plan to acquire Sprint. Let us look on the events thereafter.

2001 : WorldCom merges with Intermedia Communications Inc., a provider of data and Internet services to businesses.

2002 (March) : A WorldCom executive complained to vice president of internal audit, that CFO has decided to use his unit's reserves to reduce expenses. The Vice President raised issue with audit committee.

While WorldCom's closest competitor AT&T was suffering from a telecom rout and losing money throughout 2001, WorldCom continued to report a profit. That had attracted the attention of regulators Securities and Exchange Commission, who thought WorldCom numbers looked suspicious. On March 07, 2002 SEC requested for certain accounting information. The Vice President launched Financial Audit.

2002 (April) : WorldCom informed that it was cutting 3,700 jobs in the U.S., 6 percent of WorldCom group's staff, 4 percent of WorldCom's overall work force. Standard & Poor's cut WorldCom's long-term and short-term corporate credit ratings.Moody's Investors Service cut WorldCom's long-term ratings and Fitch also cut the company's ratings, saying it expects WorldCom's revenue to deteriorate during 2002, with uncertain prospects for recovery. WorldCom Chief Executive Officer Bernard Ebbers resigned amid slumping share prices. SEC ordered probe of the company's support of personal loans. Vice Chairman took reins of company.

2002 (May) : Moody's cut WorldCom's long term debt ratings to junk status, citing the company's deteriorating operating performance, debt and expectations for further weakness. Standard & Poor's cut WorldCom's credit rating to junk status.Standard & Poor's removed WorldCom from its S&P 500 Index.

$500 million in fraudulent computer expenses was uncovered by a member of internal audit team. After this incident, the Vice President (Internal audit)and the internal audit team decided to check the accounts secretly. In late May 2002, the team discovered a gaping hole in the books. In public reports the company had falsely categorised billions of dollars as capital expenditures in 2001. This allowed WorldCom to turn a $662 million loss into a $2.4 billion profit.

2002 (June) : The CFO, asked the internal Audit Head (Vice President Internal Audit) to delay the Financial audit which was refused. The Vice President confronts other WorldCom officials about the increasing number of accounting problems and presented findings to WorldCom's board. Four days later the CFO was fired.

WorldCom announced that it had inflated its profits by $3.8 billion over the previous five quarters. Nasdaq market halt trading in WorldCom's two tracking stocks, WorldCom Group and MCI Group. Shares of WorldCom touched as low as 9 cents before the halt. US President George W. Bush called for full investigation of the matter.

2002 (July) : WorldCom revealed that an internal investigation had uncovered questionable accounting practices stretching back as far as 1999. WorldCom chief executive appeared at a

Washington press conference to apologize for the company's accounting scandal. He also said the company hopes to avoid a bankruptcy filing.

July 21, 2002 : **WorldCom files for bankruptcy protection, listing its assets and debts on a consolidated basis as of March 31, the largest such filing in U.S. history.**

2002 (August) : WorldCom's former Chief Financial Officer and former Controller were arrested for their role in the scandal. WorldCom's internal auditors uncovered an additional $3.8 billion in improper accounting, doubling the amount of its known accounting errors to more than $7.6 billion over the past two years.

2002 (September) : WorldCom chief executive agreed to step down and WorldCom Inc.'s former controller, pleaded guilty on three counts of conspiracy, securities fraud and making false statements to the Securities and Exchange Commission.

On November 27, 2002, WorldCom reaches initial settlement with SEC, in which the company agreed to continue to submit to federal oversight. In December 2002 Six WorldCom directors resigned.

2003 : In May 2003, WorldCom agreed to pay investors $500 million to settle civil fraud charges. In July 2003, federal judge approved a $750 million settlement between WorldCom and federal regulators. In August 2003, WorldCom appointed former AT&T Corp. executive as its new president and chief operating officer. In October 2003, WorldCom Inc. announced the appointment of a chief ethics officer to report directly to the chief executive.

On October 31, 2003 the U.S. Bankruptcy Judge Arthur J. Gonzalez approved WorldCom Inc.'s reorganization plan.

2004 : On April 20, 2004 MCI officially emerged from bankruptcy, 21 months after filing the largest Chapter 11 Bankruptcy case in US Corporate history.

On August 12, 2004, the Justice Department gives a New York investment firm permission to acquire a controlling stake in MCI Inc.

2005 : In January 2005, the lead plaintiff in the WorldCom class-action suit formally announced a $54 million settlement covering 10 former WorldCom directors. In February, 2005 federal judge rejected part of a groundbreaking settlement in which 10 former WorldCom directors agreed to pay $54 million to settle a shareholder lawsuit.

In March 2005, Former WorldCom Inc. chief executive Bernard J. Ebbers was found guilty of conspiracy, securities fraud and making false filings with regulators.

HOW STAKEHOLDERS WERE AFFECTED IN WORLDCOM EPISODE

Shareholders : The company's stock which was rated earlier by Wall Street as B+ was downgraded to CCC after the scandal.The sharevalue was declined by 95%.

Employees : Worldcom laid off more than 20000 employees.

Financial Institution : Twnety five banks sued Worldcom for defaulting on its loan payment amounting to $2.6 billion.

Customers : Worldcom bankruptcy joeparadised service to its 20 million retail customers apart from the many government contracts, affecting 80 million social security benefeciaries, air traffic control for federal aviation association, network management for the department of defence and long distance services for both houses of the congress and general accounting office. Thousands of companies across the globe who depend on Worldcom were also affected.

RESTORING TRUST

Richard Breedan, a former Chairman of the US Securities and Exchange Commission submitted to the United States District Court, a study of Corporate Governance and a plan of action for changes that he wanted to put in place. He called this document "Restoring Trust". It had 78 recommendations on Corporate Governance at Worldcom including the establishment of Governance Constitution for the Company, increased shareholder communication, an active, informed and independent Board, auditor rotation, compensation limits etc.

CONCLUSION

As discussed in the preceding paragraphs a chapter 11 bankruptcy involves a reorganization plan that accommodates debt reorganization through a payment plan and the major advantage is that the debtors generally remain in possession of their property and operate their business under the supervision of Court. Chapter 11 debtors also often keep a substantial portion of their assets. The provisions of Chapter 11 allow the debtor relief from pending obligations and the opportunity to reorganize its business and restructure debts while continuing to operate the business. Under this chapter a company can choose to sell off particular assets. Accordingly subsidiaries outside US need not be included in the Chapter 11 filings as happened in GM case.

There is therefore no change in the legal status of its subsidiaries that are kept out of Chapter 11 filings. Further Debtors Audit, Debtors Counselling, Mandatory debtor education etc are provided under US Bankruptcy laws which helps in minimizing the fraudulent bankruptcies. In the light of the above, a need is felt to have similar legal framework in India which allows continuity of business during bankruptcy proceedings, control over the management of company filing bankruptcy application, keeping subsidiaries /certain assets outside the purview of bankruptcy application etc in line with Chapter 11 of US Bankruptcy Code.

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Sub - Theme 2

Integrity, Ethics & Governance

ETHICS, CORPORATE GOVERNANCE AND THE STATE : THE NEED FOR SYNERGY

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CORPORATE GOVERNANCE : CORPORATE DISASTERS AND ETHICS

Amidst the expectations created by the recommendations of the Cadbury Committee and the international wave of changes in stock exchange rules, listing agreements, company law, codes and accounting, reporting and disclosure standards, there were apprehensions whether the "good house-keeping" efforts would bring about proper corporate governance at all. The worry was that improvements in the board structures, practices, reporting, and disclosures may enhance the quality of the existing practices and yet may lead only to an incremental improvement over the assurances given by audited accounts and reports (Reddy, 1997). Such good house-keeping measures may yet provide scope for unethical actions and frauds. However, these noises were muted swiftly by the rising tides of fashion for symbolism, passed away as good corporate governance.

The current spate of corporate collapses and accounting frauds has thankfully resurrected what could have been a closed case. It is becoming clearer that mere house-keeping will not improve the standards of corporate governance but may even create a new market for manipulations and management of auditors, rating agencies, media, and other intermediaries and reputation agents. Good housekeeping is a necessary measure without doubt and yet will not be sufficient (Reddy, 1998). The sufficiency criterion can only be fulfilled by values, ethics, and the attendant processes. The problem, of course, is that the soft approach or values and ethics suffer from great fuzziness and definitional issues unlike the categorical nature implicit in the structural approach advocated through corporate governance principles, accounting standards, listing agreements, reporting and disclosure criteria.

The dramatic problems during the last few months underscore that the inadequacy of informational transparency and standards is as daunting as the challenge posed by the fuzziness of ethics. We have noted a string of confidence-shattered episodes such as those of Enron, Global Proxy, Xerox, WorldCom, and worse still, even Johnson & Johnson that was revered for its ethical stand during the Tylenol crises of the 80s. The new debate about the shortcomings in the corporate governance has been led by the Enron collapse. McLean (December 2001) gave the recipe for corporate governance failure : "Start with arrogance. Add greed, deceit, and financial chicanery. What do you get ? A company that wasn't what it was cracked up to be."

For years at a stretch, Enron was ranked among the most admired, most innovative, fastest growing and one that will topple the old behemoths that were too heavy and slow. Grow it did, into vaguer and vaguer businesses. It kept everyone guessing and in the dark, fooling even the employees to hold their options and buy more shares even as the top bosses off-loaded theirs. Auditors, research analysts, bankers were all party to this collapse of the seventh largest corporation in America, the country that the world believed to be the Mecca of corporate governance, share-holder activism, fiduciary capitalism of the institutions and watchful regulators.

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WorldCom Inc followed closely in murky affairs trying to pass off 3.8 billion dollars as capital expenditure to be able to show more profits. Xerox Corporation overstated its profits by about 2 billion dollars and dragged its Indian arm into the scam for having paid bribes till 2000. The list seems to enlarge by the day with our own NBFCs, Urban Cooperative Banks, new private sector banks, stockbrokers, Government sponsored/ owned financial institutions contributing to the loss of credibility and capital market distress. Time has aptly described this as a 'Season of Mistrust'. (Gibbs, Nancy,2002).

A Time-CNN poll in the USA has shown that 72% of the respondents believed that these were not isolated cases but may indicate a pattern of deception on the part of large corporates. 69% of them repose lesser faith now in the CEOs. 59% have lesser faith now in the major corporations; 53% have expressed lesser trust of stock markets and 36% even in the federal Government. 71% of the respondents think that compared to the average person, the typical CEO is less honest and ethical. (Gibbs Nancy, 2002).

The recent well-rhymed statement of a top world statement – There is no capitalism without conscience; there is no wealth without character – felt that one would like to comment, in view of certain later developments about company management and share-holding that have been reported in the press.

Ethics is exactly about this grey area where things are not black and white. Box ticking compliance is not necessarily good corporate governance unless they pass the scrutiny of professional standards and ethical judgment. Unfortunately, ethics has not been sufficiently integrated with corporate governance and has been treated as a separate subject. In fact, successful managers seem to believe deep inside that ethics probably impedes performance. Temperance, values and ethics are used as tactics of symbolism that may help quick growth and performance. It is interesting to note that a survey in USA of 2000 MBA students revealed that after the course, they actually rated share-holder value higher and customer and quality lower than they did before the course. Obviously, the language of Sun Tzu, competitive strategy, benchmarking, and the case studies of corporate wars have all crowded out the relevance of ethics and values. There is no corporate folklore that evokes moral behaviour. (Economist, 2002).

CORPORATE SOCIAL RESPONSIBILITY : STAKEHOLDERS AND ETHICS

To make matters worse, Corporate Social Responsibility has been manipulated to suit ones disposition and ideology. Thus, Milton Friedman's (1983) famous saying that "the business of business is business" has been used to hint at the needlessness of ethical concerns, whereas the Friedman argument was entirely different and for fear of adverse trade-off with shareholder returns and the potential for unethical tendencies among Corporates. Even among several multi-lateral organizations, aspects of CSR, stakeholders, values and ethics have been noticeably underplayed. Take the OECD principles of Corporate Governance for example. The relevant principle states, "The corporate governance framework should recognize the rights of stake-holders as established by law and encourage active cooperation between corporations and stake-holders in creating wealth, jobs, and the sustainability of financially sound enterprises". (OECD, 1998)

There is no mention of values, professionalism, or ethics in the principles. Both the OECD and the Global Corporate Governance Forum at the World Bank reflect the dominant perspective of free markets and capital markets as an answer to problems of economic growth. Consequently, the OECD principle suggests that corporations comply with the law in protecting the interests of stake-holders and provide them with an opportunity to redress violations of their rights. The principles see stakeholder engagement as a process of performance enhancing strategy.

Similarly the Business Round-table Report (1997) is categorical that "the principal objective of a business enterprise is to generate economic returns to its owners …….. the notion that the Board must some how balance the interest of stockholders against the interest of the stake-holders fundamentally misconstrues the role of Directors".

The CACG has adopted a more inclusive approach and refers explicitly to values, ethics, and professions. The CACG guidelines appear to promote better stakeholder engagement and that strategies should be supported by values. The principles also recognize that "while the Board is accountable to the shareholders of the corporation as the owners of its capital, society expects a corporation to act responsibly in regard to aspects concerning its broader constituency such as the environment, health, and safety, employee relationship, equal opportunity for all employees, the effect of anti-competitive practices, ethical consumer conduct, etc". (CACG, 1999). The principles expect that the Board monitors on a regular basis to determine that the corporate governance framework in the organization remains valid and consistent with its strategy and values. In the principle relating to communications, the CACG guidelines reiterate the need for the corporation to go beyond the statutory minimum and assume responsibility to ensure that the communication is in the spirit outlined, which actually is good corporate citizenship.

Amongst various reports, principles and codes, the King Report on Corporate Governance of South Africa has integrated the ethical content of Corporate Governance with those of the structures, systems, and processes. (King Report 1994 and 2002). The Code, which is a part of the report, is an outstanding document that covers the obligations not only of the Board and owners but also those of the managers, employees, suppliers, and vendors, customers, and the society at large.

ETHICS, MANAGERS AND PROFESSIONALISM

Amongst the actors in the corporate thea tre, managers probably have a singular responsibility to integrate ethics into their conduct for two interrelated reasons. Firstly, most unethical actions are at the individual level than as a collective formal decision of the Board or the Management Committee. Thus, operational decisions that attract risk or expose the companies to a risk are often taken at the managers level. It is the individual sensitivity to aspects of ethics that will contribute eventually to an active stand by the company while taking even strategic decisions. When managers and directors learn to speak the language of ethics, they will tend to recognize ethical dilemmas. Once these are recognised, the sieving process begins of those which can be averted and those where the answers are not so easy. Sensitivity to ethics will not only enable employees to reduce transactions such as those of misusing expense accounts, misusing leave provisions, window dressing the financial statements, cronyism in employment and selection of suppliers, actions leading to environmental degradation, sexual harassment at work, violation of minority rights, etc. but will also help in corporate strategic decisions such as whether to enter into a questionable product line, enter into a joint venture with a known corporate criminal, use auditor clout to earn more income through consulting and the like.

Overstating the profits and making things better than they are is a classic case, which often begins with a small judgment, exercised to look better in the eyes of the boss, the public or the share-holders. It leads to gradual enlisting of more people to cover up more and more till the bubble bursts like that of Anderson. In many cases it all begins with technical / professional mismanagement leading to cosmetic management at the individual level and then to enlisting others by creating illegal / unethical incentives. The "group think" takes over from then on and a tide-wave of desperation begins eventually leading to frauds and misfeasance. One would like to believe that Anderson's actions possibly fall into this pattern. There are of course, less iterative progressions to fraud when the individual owner, employee or a group is motivated to commit fraud straightaway for audacious greed and adventurism.

The potential for corporate risks will obviously mitigate if an ethical compass is implanted in the conscience of all directors and employees. Such a compass will ensure that the company does not suffer from ethical complacency. Driscoll and Hoffman (1998) warn sternly of the ubiquitous problem of ethical complacency and say, "This is one of the most difficult warnings to see since complacency diverts people's attention. In the case of ethical complacency, directors, managers and other employees think that an ethical problem can't happen to them because 'we are good people' or 'we just wrote a new code of ethics' or 'we have never had a problem' or some other rationalizations".

The second reason that should compel managers and directors to study the ethical component of Corporate Governance is related to professionalism. Several managers belong to strong professions such as those of accountants, company secretaries, and lawyers. There are others, which are fledgling to become true professionals like those of human resources, advertising, and marketing. These functions must recognize that a profession has an intimate connection with welfare, and is strongly based on aspects of ethics, and values. The standards, principles, codes and best practices evolved in these professions are founded on assumptions of human welfare. The professional is thus expected to owe an allegiance to his calling, which expects him to put his personal interests or that of the company behind those of the professional standards. A professional is expected to have five distinctive attributes (Reddy, 1990):

- A commitment to a calling which has a set of normative and behavioural expectations

  A specialized education and training of substantial duration.

- Membership of an association comprising of similarly trained and practicing individuals for the purpose of protecting and enhancing the interest of the calling.
- A service orientation keeping in view the requirements of the client and the society.
- A relative degree of autonomy in the use of his/her knowledge and skills.

It is obvious that training and sensitization may not be an insulation against fraud. Yet, an integration of ethics into corporate governance frame makes the proposition more robust, than a stultified view of corporate governance as a box-ticking process. Ethics as a professional compulsion will help progress on this integration. Despite the fact that we do not have templates for such integration, Lacznaikk's (1983) ethical propositions could be of some help. The 14 propositions are as below :

1. Ethical conflicts and choices are inherent in business decision-making.
2. Proper ethical behaviour exists on a plane above the law. The law merely specifies the lowest common denominator of acceptable behaviour.
3. There is no single satisfactory standard of ethical action agreeable to everyone that a manager can use to make specific operational decisions.
4. Managers should be familiar with a wide variety of ethical standards.
5. The discussion of business cases or of situations having ethical implications can make managers more ethically sensitive.
6. There are diverse and sometimes conflicting determinants of ethical action. These stem primarily from the individual, from the organization, from professional norms, and from the values of the society.
7. Individual values are the final standard, although not necessarily the determining reason for ethical behaviour.
8. Consensus regarding what constitutes proper ethical behaviour in a decision –making situation diminishes as the level of analysis proceeds from abstract to specific.
9. The moral tone of an organization is set by top management.

10. The lower the organizational level of a manager, the greater the perceived pressure to act unethically.
11. Individual managers perceive themselves as more ethical than their colleagues.
12. Effective codes of ethics should contain meaningful and clearly stated provisions, along with enforced sanctions for non-compliance.
13. Employee must have a non-punitive, fail-safe mechanism for reporting ethical abuses in the organization.
14. Every organization should appoint a top-level manager or director to be responsible for acting as an ethical advocate in the organization.

The ethical component of governance can easily get facted in the maze of decisions at corporat or operational level if profit alone is the motive. Decisions of all hues fall in this catgory, and we can see these happen all around in day-to-day life of many corporations. (see Box 1)

ETHICS, GOVERNANCE AND THE STATE

In a limited sense, corporate governance applies only to publicly listed and traded companies. Their number, especially in the case of developing countries, is fairly small though they may account for a large portion of value addition and manufacturing assets. In most countries, such companies account for less than 3 per cent of the total number of registered firms. The convergence of ethics with corporate governance will ensure higher productivity, greater investor confidence, better development of capital markets, and contribution to economic growth apart from reduction in potential systemic risks and social costs. Yet its impact can be limited especially if the macro-policy environment itself is unsporting. Corporate governance and ethics will thrive only if the environment is made conducive by the State. Since the State is not expected to be selective in its responsibility to the corporates, it must be in a position to create an environment, which will, ideally enable pursuit of welfare by all institutions, and individuals concerned.

This is the area of good governance where those in power have the motivation and conscientiousness to build institutions and administer them in a manner that promotes welfare. The State has the responsibility to establish institutional mechanisms that include creation, protection, and enforcement of rights; provision of a responsive regulatory system; and active curtailment of corruption and promotion of poverty alleviation.

BOX 1

Illustrative Levels/Categories of decisions	• Possible Unethical Decisions having an impact particularly on environment.
CORPORATE STRATEGY	
Choice of Business	• A company in electronics, textile, tyre and chemical business entering into a joint venture for manufacturing categories.
	• A company manufacturing fertilizers going in for takeover of a D.D.T. making plant while a viable alternative of bio-fertilisers existed for it.
Regions	• Direct or indirect business operations in globally ostracized nations.
	• Operations in regions of the world for political purposes unrelated to the explicit mission. (The ITT controversy in Chile, for example).

BUSINESS STRATEGY

Choice of Product Lines
- Choice of an existing cigarette manufacturer in a developing country to launch a major expansion programme instead of diversifying.
- Manufacture of bottles meant for illicit brew.

Choice of Technology
- Purchase and attempted import of an obsolete thermal power plant which is environmentally hazardous.
- Using PCP route for manufacturing leather goods or the PFC in refrigeration.

Choice of Location
- Locating in environmentally fragile regions; locating a polluting pharmaceutical factory close to a drinking water resource.

Choice of Market
- Choosing to induce younger population segments (12 years) to smoking.
- Canvassing poor products in vulnerable population segments (segments chosen because they are ignorant).

OPERATIONAL TACTICS
- Foiling product launches of the competitors (interference, product adulterations, etc.)
- Gathering confidential information of competitors through fake interviews, targetted recruitents, etc.
- Shutting off ETP in the night to save on operating costs.
- Choosing packaging from forest poachers when better alternatives exist.
- Litigating in courts against justifiable orders of the pollution control agencies deliberately to gain time/save cost.
- Launching misleading advertisements.
- Others such as : Fudging accounts, showing one Head for the other.
- Inflating profits; choosing inconsistent accounting policies that would improve profits.
- Insider trading by managers.
- Nepotist appointments as suppliers / vendors.
- Non-disclosure of conflicts of interests/related party transactions.

(Adapted from YRK Reddy : "Ethics and Management of Environment", Indian Management, April, 1994)

It is obvious that India has relatively weak institutional mechanisms and an environment that does not support good governance, and ethical conduct. Over the years, a structure of entrenched interests has been created that agitates against any action that is not aligned to sectional interest. A system of disincentives for ethical conduct and a demonstration that shows the success of criminality and illegitimacy has been thriving. Consequently, the worldview about India is fairly distressing. The findings of Transparency International are well known with India ranked in the last quartile amongst countries. Concomitantly, is the finding that India ranks fairly high in payments of bribes. These bribes appear to be the highest in public works, construction, arms, and defence. (*Business Line*, June 9, 2002) Another study on Asian countries carried out by the Political and Economic Risk Consultancy (*Economic Times* June 2, 2002) finds a relatively high degree of corruption in the Indian judiciary attributable to low levels of pay for the judiciary and the police.

Obviously, ethics is beyond mere compliance with law. Ethics deals with the gray area of deciding what is right and good in pursuit of welfare in every action and decision taken. In the case of the State, ethical policymakers should be dealing with the host of omissions by which institutions have remained weak, the soft State has worsened to become fluid, laws remain ineffective and unresponsive and reforms are slow with poor sequencing and wrong priorities. The ethics agenda for the policy makers in the State should contain a war against the enemy – the enemy is within having contributed through mountains of omissions if not commissions. Ethical complacency has been eroding the foundations of democracy, human rights, and welfare. Ethical complacency has led to a system where the State is no longer independent but has been captured by a plutocratic set of families, corporates, and well-oiled networks of interest groups that transcend ideologies. Truly, the State is not in control of itself. The challenge in a democracy, as James Madison said in 1788, is "in framing a government to be administered by men over men, the great difficulty lies in this: you must first enable the government to control the governed; and in the next place oblige it to control itself". (World Bank : *World Development Report*, 2002). This remains a challenge for us in India.

Policymaking is on the basis of value judgments and a system of assumptions. Aspects of distribution of income and wealth, the role of the public sector and the private sector, the importance to be given to capital markets, property rights, subsidies, licensing and control, taxation and concessions etc. will all be based on a host of assumptions. It is obvious that policy makers will differ on the assumptions, the extent of their trades-off, and the nature of outcome of various choices. For the ethically complacent and the unethical, both action and inaction will be driven by self-interest and preservation of power, prestige and wealth than an objective view of welfare. What exactly is welfare has been and will remain uncertain and debatable at all points of human action. Yet, action cannot be sacrificed at the altar of such a definitional problem. Ethics requires an application of skills, and judgment driven by the profession and the absence of personal interest and gain. It calls for breaking away from ethical complacency and adopting a degree of activist stand in creating institutions and reforming these on a continuous basis to enable a conducive environment to be created.

CONCLUSIONS

Only when an enabling policy environment is created with appropriate institutional building and reform, can we hope for corporate governance to thrive. Thus ethics, corporate governance, and governance by the State need to converge and synergise.

Ethics should not be considered as an abstraction flying in the sky. Nor should corporate governance be a symbolism of box ticking to bring temporary comfort to the greedy investors. Neither should the State be a feudal arbiter and judge that will occasionally act at the wrong time in the wrong place.

Ethics must in fact be the fountainhead of action both in the corporate as well as in the policy arena. The task before professionals, officials, and ethicists is to work harder in establishing the connections among the three more deliberately, and demonstrably.

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INTEGRITY, ETHICS AND GOVERNANCE

ARCHANA KAUL*

"There are seven things that will destroy us: Wealth without work; Pleasure without conscience; Knowledge without character; Religion without sacrifice; Politics without principle; Science without humanity; Business without ethics." ... *Mahatma Gandhi*

INTRODUCTION

All civilized society is built upon the fundamental proposition that individuals and institutions act in accordance with a code of generally accepted socio-ethical standards. Some of these standards are codified into law. But layered around the law are other values and beliefs by which men are restrained and the social interest is protected. These ethical self-disciplinary standards supplementing the law are particularly important in a country like ours in which we prize individual freedom of action as one of our most basic rights, and believe that governmental rules and regulations should not exceed those necessary to maintain an environment in which private parties are protected and assured an opportunity to seek their own interests as long as they do not infringe on the rights of others or society generally. If, however, institutions or individuals choose, as they may in our free society, not to adhere voluntarily to appropriate standards of conduct, additional laws, rules and regulations will inevitably be imposed by government to protect the public from unacceptable practices. Thus, the freedom of action which is enjoyed by individuals and institutions is dependent upon their willingness to exercise that freedom in a way that is considered to be appropriate by our society.

GLOBAL SCENARIO

Globalization, changing social mores and other factors are altering the environment in which corportaes are operating. Globalization is shaping a new system of international economic relations- be it in the field of investment, trade, finance or technology. Whether one is optimistic about the results of globalisation or suspicious and apprehensive, one has to accept the fact that we have travelled quite some distance along the road to full-scale globalisation. The explosion of new information and communication technologies is also allowing for a rapid, global diffusion of ideas and practices, enabling the stakeholders and the public at large to demand higher standards of ethics, transparency and accountability.

CORPORATE ACCOUNTABILITY: DECLINE OF TRUST AND CONFIDENCE

The business corporation is one of our great institutions. It is unsurpassed in our free enterprise system as a vehicle through which capital, labour and other resources can be managed efficiently for the production of desired goods and services and has also contributed significantly to a standard of living. In recent years, we are witnessing that the confidence of the stakeholders and the general public in business leaders has declined to a great extent questioning their moral and ethical conduct. The

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formerly accepted concept that the sole purpose of corporations is to provide desired goods and services at a profit sufficient to obtain needed capital is now being questioned. There has been increasing interest in corporate performance relative to preserving the environment and protecting customers. There is also considerable current concern whether they are properly accountable to investors and the public. These concerns reflect a perception that business is not acting in accord with today's socio-ethical values; there exists the foundation for increased governmental regulation of business.

The extraordinary events in corporate business witnessed by the world like : Enron, Tyco, Global Crossing, WorldCom, stock options backdating scandals, Wall Street analysts peddling dud stocks and the collapse of the auditors Arthur Andersen has brought the discussion of corporate governance to the fore in industry, finance and business. The behaviour of corporations and the people that run these corporations have come under increased scrutiny by stakeholders and the wider public. The failure of seemingly-infallible corporations mentioned above, has brought one clear message to the fore: ethics matters in business. You can fool some people all the time, or all people some of the time, but ultimately you cannot fool all the people all the time. If you are not running an ethical enterprise, it will cost you dearly at some point or the other.

GOOD CORPORATE GOVERNANCE – KEY TO INTEGRITY

Good corporate governance is key to the integrity of corporations, financial institutions and markets, and central to the health of economies and their stability. How we govern our corporations plays a central role in the strength and health of our global economy. Effective corporate governance systems promote the development of strong financial systems-irrespective of whether they are largely bank-based or market-based which, in turn, have an unmistakably positive effect on economic growth and poverty reduction. There is no single model of good corporate governance. What constitutes good corporate governance evolves with the changing circumstances of a company and must be tailored to meet those circumstances.

In the prevailing economic environment, the significance of corporate governance has further enhanced. Many believe that corporate governance is just another management fad. They are wrong on two counts. One: there is nothing new about the concept of corporate governance – it has been around since the time ownership and management in companies was cleaved. Two: the recent spate of serious corporate malfeasance means that corporate governance needs to be taken more seriously.

WHY QUALITY OF GOVERNANCE

There are several reasons as to why should we care about the quality of governance? The immediate one is that poor governance can harm national economic performance and ultimately global financial stability. Financial crises in other parts of the world have demonstrated this beyond doubt. They have grand exotic names. As they fall from the heady heights their impact reverberates around the globe, creating shock waves that threaten the economic stability of the entire planet. Good corporate governance structures encourage companies to create value and provide accountability and control systems commensurate with the risks involved.

The developments during 2007 and 2008 indicate that corporate governance is going to come to the fore with highest intensity. Failure of mega financial firms operating through out the world caused a worsening world economic recession through the crisis of business confidence triggered by credit crisis. Closer home corporate governance practices of the forth largest Indian software exporters, Satyam Computer Services, brought to the fore issues of business ethics and ethical behaviour. The new thrust of corporate governance issues in growth of business, interests of shareholders and other stakeholders, and confidence of regulators and Governments in the corporate ethos are going to improve the importance of governance professionals.

ETHICS AND INTEGRITY IN BUSINESS- GAINING IMPORTANCE

We cannot approach reform and good governance without including ethics and integrity. Business ethics is becoming exceptionally important in the global economic scenario. This importance is only becoming greater as more and more businesses come to existence in a global economy driven solely by the forces of capitalism and forcing companies into an enormous market with the extremity of its size matched only by its level of competition.

Ethics in business is essentially the study of what constitutes the right and wrong or the good or bad behaviour in the workplace environment. Business ethics is a form of the art of applied ethics that examines ethical principles and moral or ethical problems that can arise in business environment. It deals with issues regarding the moral and ethical rights, duties and corporate governance between a company and its shareholders, employees, customers, media, government, suppliers and dealers. As observed by Henry Ford "Business that makes nothing but money is a poor kind of business".

In today's society, understanding and practicing the concept of 'ethics' is a key factor that many organizations stress among employees. In order to enable the organizations to survive in such a competitive and changing environment, managers and supervisors must develop strong ethical standards that can be implemented throughout the company.

Ethical standards are what it means to be a good person, the social rules that govern our behaviour. Ethics is important not only in business but in all aspects of life because it is the vital part and the foundation on which the society is build. A business/society that lacks ethical principles is bound to fail sooner or later. According to International Ethical Business Registry, "there has been a dramatic increase in the ethical expectation of businesses and professionals over the past 10 years. Increasingly, customers, clients and employees are deliberately seeking out those who define the basic ground rules of their business operations …."

Integrity is a concept that is not easily comprehensible. Going through the literature, one finds it difficult to obtain explicit definition of the concept of 'integrity'. Integrity is often viewed merely as the antithesis of fraud and corruption (narrow integrity approach), or within the context of integrity/ sacrosanctity of the human body.

Integrity for a person is a matter of that person's word—nothing more and nothing less. We can honour our word in one of two ways: first, by keeping our word, and on time as promised; or second, as soon as we know that we would not be able to keep our word, we inform all parties involved and clean up any mess we have caused in their lives. When we do this, we are honouring our word despite having not kept it, and we have maintained our integrity. If you are up to anything important in life, you will not always be able to keep your word. That's all right, but if you are a person of integrity, you must always honour your word. Without integrity, the workability of any object, system, person, group or organization declines.

Over the past few years countries have broadened the concept of integrity involving stimulating personnel so that they are prepared and able to do what they have been appointed to do, and to stand by what they do. They also have to take into account all of the interests that are at issue (broad integrity approach). Key values in this respect are honesty, reliability, impartiality, sincerity, objectivity, ethics and justice.

HOW TO CREATE AN ETHICAL CULTURE

Mention has been made earlier about developing strong ethical standards that can be implemented throughout the company. Developing ethical standards implies the existence of an ethical culture in the organisation. Culture can be described but not defined easily. Nor can it be manufactured in an organisation just by putting in a programme. Rather it is perceived by those who are employed or those who come into contact with the business. At its most basic, corporate culture expresses itself in behaviour and the way a business is run. Staff are sensitive to management styles; where the prevailing culture is one characterised by greed or arrogance, it is soon reflected in the way they behave. On the other hand, if it is one of trust, integrity and openness, staff generally will feel comfortable at work and be proud of the organisation. As a result, employee attrition rates are likely to be below the norm for the sector.

Culture is also expressed in attitudes. When faced with a business problem, a manager has to balance the legitimate requirements of attaining business objectives and the ethical requirements of honesty and integrity in the way this is achieved. The culture of an organisation will be affected internally and externally by both the ways the issues are handled and how subsequent policy is implemented.

An international polling organisation, ISR, drawing on more than thirty years of internal survey work for companies throughout the world, has drawn up a list of some general aspects of corporate culture that can put companies at risk of significant ethical misconduct. Aspects of corporate culture that indicate there is risk of ethical misconduct are given herein below:

— Discussions on company values are viewed by employees as a public relations ploy rather than a true commitment.

— Acting with integrity is seen as an obstacle rather than a vehicle to success.

— Open debate, questioning of the status quo, and dissent are discouraged.

— Bad news is spun rather than confronted head-on, and there is a shoot the messenger mentality, particularly as one goes up the chain of command.

— People tend to hoard rather than share information of all kinds.

— The behaviour of high performing employees tends not to be questioned, the ends are emphasised (particularly the financial ends), and the means are largely ignored.

— There is an exclusive focus on short-term financial results, often matched with unrealistic performance expectations.

— The external environment, including customers, investors and the general public, are seen as something to be manipulated, rather than respected. [*Source: How to create an Ethical Organisational Culture, ISR White Paper. www.isrinsite.com*]

BRINGING ETHICAL CONDUCT TO THE CORE OF BUSINESS AGENDA

The effectiveness of a business ethics programme is about maintaining an attitude by all employees, from the directors to the receptionists that "how we do business" really matters. A company with this approach is likely to be characterised by, among other things, a culture of trustworthiness. If this is recognised as a desirable characteristic of the firm, then it will be important to cultivate it by being open and transparent throughout the organisation. Maintaining trust internally between staff and externally with business customers and partners, is a key element in sustained business success.

Senior business leaders have to start giving more thought to this area of organisational behaviour, start framing their beliefs on integrity standards, circulate these among their employees and get their concurrence and affirmation on adherence to these standards. More important, senior leaders must create communication platforms that encourage employees (and other associates of the company) to raise concerns related to possible or actual deviations from integrity standards especially those that could damage the reputation of the organisation. All such platforms and processes must get institutionalised in due course.

BACKGROUNDER

Among the first issues that merit discussion in organisations desiring to be seen as ethical are the following:

— Creating the post of ethics practitioner or counsellor, with a specific description of the job and its responsibilities.

— Discussion of ways and means of embedding values in an organisation.

— Route map for implementing a code of conduct and establishing a clearly stated set of integrity standards.

— Working out the relationship between ethics and other business functions, and aligning company policies with the code.

— Planning for ethics training and communication to employees.

— Creating a structure for ethics monitoring, compliance auditing and whistle blowing.

Tatas for instance, have used the maxim 'leadership with trust' to promote ethical conduct throughout the group, and this is borne out by its longevity. The group's embedded values have been unity, integrity, excellence, responsibility and understanding. Since 1999, the group has circulated to all its employees a document called the 'Tata code of conduct', which is simple, easy to understand and easy to follow. In its journey towards institutionalisation, the substance of the code is constantly communicated at all levels of the organisation, apart from parties with whom the Tatas do business.

The content of the code covers such areas as commitment towards national interest, maintaining harmonious relations with employees, abhorrence of bribery and corruption, avoidance of conflicts of interest, and emphasis on corporate social responsibility. The Tata code enhances internal and external trust and confidence.

The key pitfall to avoid while drawing up such codes is that the contents should not give employees a feeling that these are a set of do's and don'ts, or that they are too complex. In fact, whenever employees are faced with ethical dilemmas, the code should offer clear integrity standards to follow. The organisation (through its senior leadership) should communicate often that it has formally adopted a specific position or set of beliefs regarding these fundamental values or principles and that it expects (and wants) employees to use them as the basis for business decision-making.

Many companies have beautifully crafted comprehensive ethics policies. However, in too many cases they are ignored either intentionally or inadvertently. If the company just has the policy as a requirement or a publicity document, or to include in a motto e.g., "we have the highest integrity in the business," and it is not backed up by a rigorous code, practice, and performance of these values, it is worse than no policy at all. Not only is it hypocritical, it is unethical, and may be illegal. If management "winks" at violations, it promotes a culture of miscreants and demonstrates a tacit approval of morally unacceptable behavior.

KEY ELEMENTS OF CODE OF ETHICS

A code's credibility depends largely on setting up an effective compliance programme, the key elements of which should include:

— Clear, established standards, policies and procedures that are reasonably capable of reducing the likelihood of violations of the code.

— Assigned supervision to high-level personnel. Each CEO should be the principal ethics officer, with the process being delegated, top down, to credible individuals in each company.

— A clearly designated ethics counsellor/ officer. At Tatas mentioned earlier, the role of the ethics counsellor is well defined.

— Encouragement to whistleblowers to report violations, or possible violations, to the ethics counsellor.

— Communication and training to all employees. This is the ultimate guarantee of the success of the ethics code.

— Establishment of uniform disciplinary actions in case of violations and taking preventive steps to head off future violations, after understanding the 'root' causes of such violations; for example, by forming appropriate organisational policies.

In a culture dominated by compliance, the question asked by employees will be: "What am I allowed to do?" rather than "What is the right thing to do?" Trust is more easily generated when the emphasis of the policy is on the application of core values and the ethical behaviour flowing from them rather than on an exclusively rule-based approach.

CONCLUSION

Ethics, integrity and better corporate governance are the tools for achieving the desired success in the global economic environment. Lax governance, lack of transparency, and corruption in particular, are key constraints to a country's global competitiveness. In a research study, "Does Business Ethics Pay?" conducted by the Institute of Business Ethics (IBE), it was found that "companies displaying a "clear commitment to ethical conduct" consistently outperform companies that do not display ethical conduct". Failure in corporate governance is a real threat to the future of every corporation. Loss of trust due to bad governance leads to ethical collapse and moral melt down of the companies which will surely show shutters to the corporates. Corporate governance practices need to be strengthened. It is time to make traditional values like honesty, integrity, decency and respectability fashionable again. We need professionals of integrity who are committed to a certain value system and, without a certain value system, no corporate governance will ever work. It's all about civilized human behaviour and making life better for the next generation.

Kenneth E. Goodpaster, professor of business ethics at the University of St. Thomas, Minneapolis, USA, emphasises that " Professionals are the principal architects of corporate conscience. They are the ones who must manage the challenges associated with pursuing profit while maintaining integrity. They are the ones most responsible for delivering on the moral agenda of the corporation. That agenda includes three broad imperatives: orienting, institutionalising and sustaining ethical values within the corporate culture."

Marianne Jennings, professor of legal and ethical studies at the W. P. Carey School, says she saw evidence of the damage wrought by isolated CEOs while researching her new book, *The Seven Signs of Ethical Collapse: Understanding What Causes Moral Meltdowns in Organizations.* In the book, Jennings explored what caused some companies -- think Enron and WorldCom -- to lose their way, and their moral compass, in pursuit of financial success. According to her the reasons for ethical collapse is due to factors such as weak Board, conflicts, pressure to maintain numbers, fear and silence, star treatment given to CEO. Jennings says. "Nobody questioned them. They had, sort of, blinders on, in that their reality was very much detached, but nobody around them would tell them that, because they were afraid and often in awe of their rock-star leader. The CEOs couldn't see their pedestal position themselves because they were running with a jet-set crowd, so isolated from ordinary folk. Real feedback was just not possible."

The ethical issues in business have become more complicated because of the global and diversified nature of many large corporations and because of the complexity of economic, social, global, natural, political, legal and government regulations and environment. Given the high competitive pressures, it is easy for business leaders to say that enforcing ethical conduct is difficult, but this is not an excuse they can use. As Jeffrey E. Garten, Dean of the Yale School of Management, wrote in his book, *The Politics of Fortune: A New Agenda for Business Leaders.* "The essential point should not be lost: the more complex the markets become, the more the integrity of its leaders matters, and the less likely that higher prescriptive laws and regulations will really matter."

Ethical leadership is the greatest challenge facing much of the world today. Company Secretaries, who play an increasingly visible role in enabling the business to meet their global aspirations and to achieve the distinction of true corporate citizens, need to remember that leading by example is the first step in fostering a culture of ethical behaviour in the companies. They have to show by example that the way the firm does business matters. It is their responsibility to guide the senior management to conduct the business and its affairs in an effective, responsible and ethical manner, consistent with the principles and direction established by the Board through the strategic plan.

Best practices in corporate governance can emerge when informed by an established set of business principles and a defined approach towards organisational behaviour. Without such business ethics, governance stands bereft of a well-reasoned rationale. Left to itself, corporate governance runs the real risk of becoming a mere form-filling exercise, dedicated to observing form. The roadmap, thus, needs to be based on substance, which means adhering to a dedicated code of behavioural norms in its spirit.

Leaders in both the public and the private sectors have to raise the bar on ethical behaviour. An honest system of governance will displace dishonest persons. As Gladstone so aptly said, “The purpose of a government is to make it easy for people to do good and difficult to do evil”. “Rivers do not drink their waters themselves, nor do trees eat their fruit, nor do the clouds eat the grains raised by them. The wealth of the noble is used solely for the benefit of others.”

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BACKGROUNDER

ETHICS, INTEGRITY AND GOVERNANCE

SURYA NARAYAN MISHRA*

Ethics, Integrity and governance are the most debated topics the world over today. These have become top concerns at international business community and financial institutions. Ethical behaviour is a fundamental corner stone of good governance. It is critical to ensure integrity in decision-making and quality of public service, and is essential to ensure citizens' trust. What's more, subscribing to ethics as a basic value for all operations is key for good business and good outcomes. Processes in place provide supervision and assistance and enable follow up of non-compliance. A structured process therefore should be in place to monitor official conduct and professional behaviour.

The individual wrongdoing and institutional failure is due to moral crisis. It is now an expected demand from the individual – corporates – institutions –government what is called accountability based on morality. A major problem with morality is that if no one claims responsibility for deciding and acting out the ethical principles of right and wrong, morality becomes a word without meaning. Morality is a system of principles or rules of conduct, which the humans are expected to conform to.

The morality and values come from upbringing, education, environment, reading and practicing the good in society and inculcation of good culture. The values become attitudes, attitudes become habit, habit become characters and characters become destiny. The rules of exceptions are has its place here also. Individual character has a say on the group character and national character. The adage if you have lost character everything has lost, is true even today, be it individual, organization, business or any other social institution. The time is now for building individual character for creating an organizational and national character.

ETHICS

Values and ethics are an essential part to human life. They differentiate between right and wrong. What is valued defines character because it shows what is most important. When people have good values, it can carry into other areas of life; both professional and personal.

Values and Ethics apply to both personal and professional lives. Understanding and implementing values and ethics in everyday practices promote ones success. Ethics is an external system of rules and laws. Usually there are rewards when you are follow the rules and punishments for defying them. Many organizations have developed a code of ethics that members, employees and group are expected to adhere to.

Ethics, *Morals* and Ethics of Responsibility

- The organization's values and code of conduct reflect the professions/organizations Code of Ethics and define the standards of behaviour. People management frameworks define the

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response to non-ethical behaviour. The purpose of ethical standards is to provide an implicit foundation upon which human interactions can proceed smoothly.

"Some people live to work; while others work to live." Values are the rules which help us in making decisions about right and wrong, should and shouldn't, good and bad. One can have professional ethics, but seldom hear about professional morals. Ethics tend to be codified into a formal system or set of rules which are explicitly adopted by a group of people. Ethics are internally defined and adopted, while morals tend to be externally imposed.

Ethics of principled conviction asserts that intent is the most important factor. If one has good principles, then he will act ethically. "*Ethics of responsibility* challenges this, saying that you must understand the consequences of your decisions and actions and answer to these, not just your high-minded principles." The medical maxim 'do no harm', for example, is based in the outcome-oriented ethics of responsibility.

Ethics Management

Ethical behavior is typically managed in the organizations through regulatory systems that move to defend and guard against employee wrongdoing. But despite leaders' best efforts to create an effective ethical defense, moral failure is all too frequent. It should be no surprise that compliance-based mechanisms achieve only a moral baseline, as defensive routines serve as a starting point for ethical behavior but do not drive proactive moral action. While rules serve to inform how to prevent wrongdoing, they do not describe, direct, or advance moral excellence. If organizations hope to win the battle over moral mediocrity perhaps it is time to consider a more integrated approach to ethics management. To elevate moral excellence in the workplace, there is need to augment the existing programs, focusing on not only the means to avoid unethical action but as a way to promote moral action as well.

To exceed moral mediocrity the baseline must be define. Drawing from Johnson's discussion on *Ethics and the Executive* (1981), the moral minimum is defined as behavior based upon doing no harm to others. Moral excellence, on the other hand, is living to a higher standard. This implies that the individual causes no harm and also assumes responsibility to help reduce harm and/or adverse impacts to others. Therefore, to exceed the moral minimum and move toward moral excellence, proactive efforts are required.

Coupled with managerial exemplars, social norms are linked with successful ethics management, as characterized by employee attitudes of commitment to ethical behavior. Social norms can be reflected in the behavioral patterns of organizational members that emerge over time. It is important to remember that these patterns are composed of individual behaviors. While behavior is obviously influenced by many factors, social norms and the application of personal and professional values to one's daily actions creates a rich picture, which, to some degree, reflects the moral strength of the organization.

Given that the social norms have such powerful influence over ethical behavior, the issue is, as to how to create and shape norms to develop workplace with moral strength? Thomas, Schermerhorn, & Dienhart (2004) propose that leaders must strategically create ethical behavior by engaging in specific proactive ethics change. To do so, they suggest that leaders must first assess the costs of ethical failures to instill urgency. Second, organizational members must be influenced to make ethical choices and finally, to develop integrity programs to help build culture where ethical norms predominate. Stemming from their recommendations, proactive mechanisms to complement existing reactive strategies would be useful to create and promote positive organizational ethics change.

Ethics management can shift the moral mindfulness of organizational members in positive directions, but this necessitates social contexts where professional moral courage becomes a clear and compelling norm for all—as a habit of choice.

Professional and Workplace Moral

If organizational leaders expect moral excellence to be exercised habitually, it is important to understand the means and ways that impact the desire to execute moral courage as an automatic choice. Morally courageous acts go beyond what is generally demanded by one's professional ethical obligations and can likely require the ability to overcome negative impacts to self. Often times the individual anticipates that the act will influence a change in circumstance and, rather than placing the primary focus on the self (e.g., What will happen to me?), focuses on factors that promote the moral purpose. Instead of considering personal well-being the individual examines their core standards, values, and principles to determine their action as they face the ethical challenge. It is important that they surmount personal concerns to enact both personal and professional moral values. As Aristotle suggested long ago, courage is both an end and a means to create comprehensive good, asserting that it is the golden mean between reason and action.

Those who exercise moral courage in the workplace may have to engage in actions that defy convention or authority. To demonstrate professional moral courage is to strive for moral good while doing one's job, regardless of significant obstacles. Professional moral courage as the ability to choose right action based upon the ethical standards of one's profession, while displaying the necessary moral strength to venture, persevere, and withstand negative emotions, risk, difficulty, or threat to self. Morally courageous actions are typically those requiring extreme action such as whistle blowing.

To cultivate and sustain moral excellence with proactive ethical behaviour, the organization's systems, structures, and processes must instill and support offensive strategies. Toward this end, leaders need to model proactive engagement and openly discuss, develop, support, and reward daily actions that reflect professional moral courage.

INTEGRITY

Walk and talk (word and action) alignment is one of the main cornerstones of the preaching integrity. In the past, answers to violations of integrity were often sought in traditional rule and check-oriented solutions. Similar modernistic solutions are at odds with developments that have occurred within society over the past two decades. In this regard, the OECD states that: "…a country's ethics management regime should be consistent with it's approach to public management in general…it would be inconsistent to marry a strict centralised compliance-based ethics infrastructure with devolved results-based management systems."

The report also mentions that legislation is not the calibrated instrument for restoring integrity: "…there are drawbacks to overly relying on legislation in an ethics infrastructure. It tends to encourage minimum compliance. The enforcement of sanctions, while necessary, is designed to discourage undesirable behaviour rather than promote desired behaviour. Because of its conceptual reliance on absolutes and objectivity, the law can be an inflexible tool for the day-to-day management of workplace ethical problems". Merely focusing on the development of stringent guidelines and procedures is therefore also counterproductive from that perspective. All the more so since working with rules and checks provokes the impression of distrust.

Concept of Integrity

Being true to one's self, one's values, beliefs, and standards are essential when it comes to successful in life holding head high. Integrity "comprises the personal inner sense of wholeness deriving from honesty and consistent uprightness of character." Integrity is the basing of one's actions on an internally consistent framework of principles. A person of integrity does the right thing for the right reason.

Integrity is an internal system of principles, which guides our behavior. The rewards are intrinsic. Integrity is a choice rather than an obligation. Even though influenced by upbringing and exposure, integrity cannot be forced by outside sources. It conveys a sense of wholeness and strength. People of integrity are guided by a set of core principles that empowers them to behave consistently to high standards. The core principles of integrity are virtues, such as: compassion, dependability, generosity, honesty, kindness, loyalty, maturity, objectivity, respect, trust and wisdom.

Behaviour is increasingly being grouped under the denominator of integrity. Initially integrity placed more or less only on the phenomenon of fraud and corruption. But the focus has shifted increasingly to 'softer', social forms of integrity. Integrity is placed in a context of leadership, exemplary behaviour, working environment, job motivation, satisfaction, pestering, discrimination and the respectful treatment of fellow citizens, members and colleagues.

Integrity being increasingly regarded as a quality-related aspect of the organization, it should be an integral part of operational management. Integrity and operational management can be related to one another in at least two ways. Firstly, if operational management is not in order due to inadequate administrative organisation and insufficient control and accountability mechanisms, the likelihood of integrity-related incidents will increase. Secondly, operational management and the functioning of an organisation may be at risk in its entirety if violations of integrity occur.

Harmonising Ethics and Integrity

One can describe a person as having integrity to the extent that everything that person does or believes: actions, methods, measure and principles — all derive from the same core group of values. Ethical meanings of integrity used in medicine and law refer to the wholeness of the human body with respect for "sacred" qualities such as a sense of unity, consistency, purity, unspoiledness and uncorruptedness.

There is a dynamic relationship between integrity and ethics, where each strengthens, or reinforces, the other. Personal integrity is the foundation for ethics - good business ethics encourages integrity.

The right thing to do is not always the easy thing. It can be challenging for organizations to establish and then comply with their own ethical standards. Whether ethics are defined or not, people at all levels experience pressures to act against ethical standards and counter to their own integrity. It takes awareness and courage to act in that moment; to hold out for a choice that is in alignment with the stated ethics of the organization and the integrity of those involved.

GOVERNANCE

"Governance" is what a "government" does. It might be a geo-political government (nation-state), a corporate government (business entity), a socio-political government (tribe, family, etc.), or any number of different kinds of government. But governance is the kinetic exercise of management power and policy, while government is the instrument (usually, collective) that does it.

As a process, governance may operate in an organization of any size: from a single human being to all of humanity; and it may function for any purpose, good or evil, for profit or not. A reasonable or rational purpose of governance might aim to assure, (sometimes on behalf of others) that an organization produces a worthwhile pattern of good results while avoiding an undesirable pattern of bad circumstances.

The test of Good Governance is to promote physical, social and spiritual development of the people. Governance is the manner in which authority, control and power of government is exercised in mobilising the society's economic and social resources to address the issues of public interest. The concept of good governance as laid out in ancient sanskrit literature,as the comprehensive and ultimate solution to achieve the ideal state of bliss and overcome the crisis in administration. The foundation of good governance in sanskrit literature is based on Dharma (righteousness) which immediately distinguishes it from the present materialistic repository of values which can ensure achievement of administrative excellence.

Good governance has Eight major characteristics - it is participatory, consensus based, accountable, transparent, responsive, effective and efficient, equitable and inclusive and follows the rule of law. It assures that integrity is maintained, the views of minorities are taken into account and that the voices of the most vulnerable in society are heard in decision-making. It is also responsive to the present and future needs of society.

Interface between Governance - Integrity - Ethics

Bhagaban Shri Krishna in Srimad Bhagwad Gita Says- Satwic leadership means leading with Honesty, Integrity, trustworthiness, compassion and competence. Effective leadership character should incorporate integrity and focus on people and competency. Satwic character radiates these qualities. It presents hope and inspiration to the people. Mahabharat – the Indian apic insists on integrity. It is never right to do wrong. **Whatever you sow, that you will reap**. Wrong deeds are punished sooner or later in unhappiness and failures. Right actions (Karma) are rewarded in well-being and success. Intelligence, goodness, wisdom and integrity are to be practiced. Ignorance, dishonesty, avarice and fraud are to be avoided. We should reject the temptation to be dishonest and unscrupulous.

The lessons in corporate governance from Kautilya's Arthashastra are relevant even today and can be integrated into the modern context of corporate management towards achieving the ultimate aim of corporate governance, which is to provide value to shareholders and stakeholders. Kautilya believed that institutions are a prerequisite to economic growth, and the good governance, knowledge, ethical conduct and economic growth are interdependent. In sum, Kautilya believed in the virtuous cycle of economic growth.

Integrity has to do with the ethical rationality. Every action, or so to say every reaction has to be good in terms of moral principles. The legal system does not give all answers to a person who is in charge of governance, as to, how to act in a given concrete situation. Integrity is an other dimension than effectiveness and efficiency. The values and norms in society and the values and norms living in the administration that are the basic for integrity, do not necessarily fall together but they are interdependent. Integrity needs and guarantees a certain level of moral quality.

As the Business ethics relates to transparency, accountability and timely disclosure of material information to gain the confidence of all stakeholders, Good Governance and business ethics are to be incorporated into the all functional areas of the business to ensure transparency, accuracy, accountability and reliability. Hence, the integrity coupled with ethics can enable the businesses to ensure of governance.

Ethics, Integrity and governance are not just "moral" or "compliance" issues. In the long term, they are essential behavioural traits for the organisation that strengthen brand equity and help ensure sustainability.

CONCLUSION

A conscious attitude of integrity – which can be seen as a moral virtue - implies the awareness of one's economic-political and ethical responsibilities as an Agent to the Principal and the significance of strict implementation of one's ethical values and principles. The higher the integrity of a top executive or administrator of an organization, the better one can expect the reputation of the organization. A good reputation in itself result in higher loyalty and trust from the stakeholders.

If businesses are to prosper well into the twenty-first century, values and ethics will be the rule and not the exception. Embedding values and ethics into the everyday business practices will promote current and future successes. The time has come that everyone must be held accountable for their actions, both in their personal and professional lives.

In its 'Global Investor Opinion Survey' of over 200 institutional investors first undertaken in 2000 and updated in 2002, McKinsey found that 80% of the respondents would pay a premium for well-governed companies. They defined a well-governed company as one that had mostly out-side directors, who had no management ties, undertook formal evaluation of its directors, and was responsive to investors' requests for information on governance issues.

A Company Secretary – key professional trained to uphold the highest standards of corporate governance, effective operations, compliance and administration, is a torch-bearer of good corporate governance. He should guide the companies on, key elements of good corporate governance namely, ethics and integrity which include honesty, trust, openness, performance orientation, responsibility and accountability, mutual respect, and commitment to the organisation.

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ENTERPRISE GOVERNANCE FOR EFFECTIVE GOVERNANCE AND PERFORMANCE

SHRUTI B GUPTA*

The failure of CG mechanism as evidenced by many corporate scandals in the USA and elsewhere in the world, highlighted the need to develop a system of governance which is holistic, consistent and performance oriented. Enterprise governance is one mechanism which realistically captures the factors that go into governing an organization. Enterprise governance recognizes that organizations need to run with integrity and they must also perform well in terms of decision making, strategy formulation and execution. It encompasses probity and profitability. The probity is concerned with observance of higher principles of integrity, the focus of profitability and financial performance. So enterprise governance integrates the notions of good governance with good performance. After all a business that upholds highest ideals but go bust are disastrous for shareholders as well as stakeholders. On the other hand, a profitable business which disregards laws and public interest has no right to remain in business.

THE CONCEPT

Enterprise governance as a concept covers both corporate governance and performance management. The concept of enterprise governance expands the reach of corporate governance beyond shareholders so as to include within its purview various stakeholders such as employees and society. Stacey Hamaker (2003) has defined enterprise governance to mean "the set of responsibilities and practices exercised by the board and executive management to provide strategic direction, ensuring that objectives are achieved, ascertaining that risks are managed appropriately and verifying that these organizations resources are used responsibly".

DIMENSIONS OF ENTERPRISE GOVERNANCE

There are two dimensions of enterprise governance:

1. **Conformance Dimension**

   This aspect has been emphasized by the existing concept of CG and it takes in its scope:

   - The role of the Chairman & the CEO.
   - The board of directors- its composition, representation of non-executive directors and training.
   - Board committees such as audit, remuneration and nomination committees.
   - Risk management and internal audit.

   Standards are notified through codes developed by different jurisdiction and compliances. These are subject to verification by independent auditors. Whereas the internal audit assures the effectiveness of the controls, the external auditor ensures that the accountability is as per the prescribed standards.

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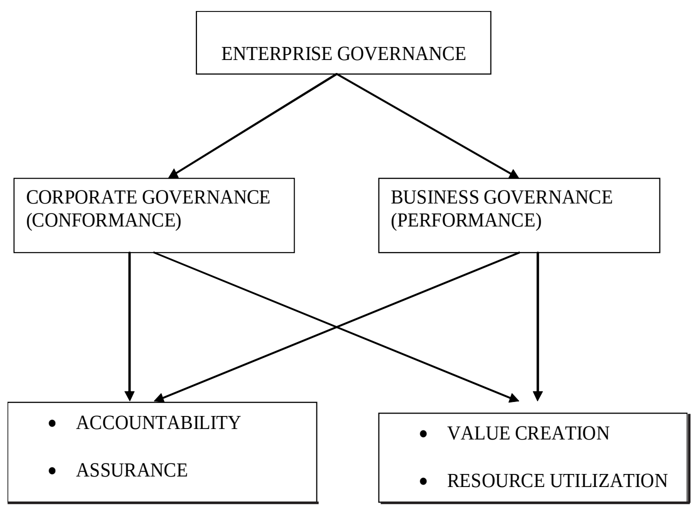
The external auditor has to check the truthfulness of financial statements from the standpoint that shareholders' interests have been properly protected. The Board discharges its responsibilities with the help of well established oversight mechanism.

2. Performance Dimension

This dimension is easily amenable to a regime of standards. Each organization has to develop a range of best practice tools and techniques for taking care of this dimension. Many of such tools and techniques exist in the domain of management accounting. The thrust of performance dimension is to help the Board to make strategic decisions, ascertain risk appetite and various other key drivers of performance. It is essential to regularly monitor the implementation of strategy, its relevance and success. There is no independent agency to vouch for the validity of any of the aforementioned variables. However there are several kinds of tools and techniques such as balanced scorecard, Porter's competition analysis model, strategic enterprise systems which can help boards to focus on strategic direction.

In view of the non-availability of any specific techniques to assess performance there occurs a kind of oversight gap. There is thus a need to develop a "strategic scorecard" for the Board. It helps the Board to guide in ensuring that good governance applies equally to the performance aspects of the business. Such a strategic scorecard should embrace the strategic objective of the enterprise, the value driver, the milestones, the timing of intended achievements and the risks to be managed. The quality of information included in developing the strategic scorecard must be of high integrity, relevant, neutral and evenhanded.

Enterprise Governance Framework



(*Source* : http://www.ifac.org/MediaCenter/files/EnterpriseGovernance.pdf)

As may be seen from the above diagram, the enterprise governance encompasses the entire accountability framework with two dimensions namely: performance and conformance. The conformance is historic focused on by traditional concept of corporate governance whereas the performance dimension makes the entire concept forward looking. Traditionally, conformance led to accountability and performance to value creation. But in the enterprise governance, conformance may feed to value creation while performance can feed to assurance. Enterprise governance will operate at three levels namely: strategic, tactical and operational (process).

Strategic Scorecard for Strategic Oversight

Strategic Scorecard is a tool for helping Boards to engage effectively in the strategic process even after the numerous challenges, such as compliance requirements, information overload and sheer lack of time. A strategic scorecard consists of four basic components as shown below:

Strategic Position	**Strategic Options**
Strategic Implementation	**Strategic Risks**

(*Source* : http://www.ifac.org/MediaCenter/files/EnterpriseGovernance.pdf)

The strategy scorecard helps the Board in discharging its strategic oversight responsibilities by giving a true and fair view of company's strategic position and progress. However, each company will have to adopt the strategy according to its requirements. It needs to be noted that strategic scorecard is pragmatic and flexible tool that helps Boards to fulfill their responsibilities to oversee strategy.

Objectives of Scorecard

These include the following:

- To assist the Board in general and the non-executive directors in particular to oversee the organization's strategic process.
- To make the Board focus on major strategic issues.
- To provide the Board strategic information in a summarized format.
- To assist the Board in dealing with strategic choice and transformational change.
- To assist the Board in identifying key points requiring decision making.

Dimensions of Strategic Scorecard

Described below are the four dimensions of the strategic scorecard.

1. *Strategic position*

   It focuses on an assessment of organization's current and likely future position. It encompasses information relating to external aspects like economic and market developments and market share as well as internal issues such as competencies and resources. The specific aspects included in this dimension include: environmental analysis, scenario planning, SWOT analysis and strategic capabilities.

2. *Strategic Options*

   This dimension builds on strategic position and dwells on options that have the greatest potential for creating or destroying stakeholder value. Options may relate to:

   — Change of scope with regard to geography, production, market sector.

   — Change of direction such as high/low growth, price, quality etc.

   — Merger, acquisitions or disposals.

   The Board should take up a few options at a time.

3. *Strategic Implementation*

   At this point, the scorecard endeavours to identify key milestones for the Board and monitors the implementation of the agreed strategy. The best analysis of organization's strategic position and identification of options will be futile if the strategy is not well executed.

4. *Strategic Risks or Strategy for Risk*

   There are three component of risk management, as under-

   — Risk appetite i.e. firm's propensity to take risk.

   — Strategic risks and opportunities facing the firm.

   — Process issues i.e. risk identification and prioritization.

THE CONSOLIDATED PICTURE

After the collection of necessary strategic information about each of the four dimensions outlined above, these must be comprised in a summarized format as illustrated below to enable the Board to exercise oversight.

Strategic Position List all the key issues such as : • Competitors activity • Legislative developments	**Strategic Options** List all the options: • Divestment of the major business • Outsourcing major process
Strategic Implementation List all action: • Introduce new product	**Strategic Risks** List all major process issues and strategic risks: • Risk appetite • Risk management capabilities • Risk management policies • Strategic risk

(*Source* : http://www.ifac.org/MediaCenter/files/EnterpriseGovernance.pdf)

How to Use the Strategic Scorecard

The company has to first prepare an initial scorecard and then use it on an ongoing basis. This responsibility may be discharged by the Board or the management or both. With the passage of time, the format of scorecard must be standardized and the directors should become fully familiarized with it. The exercise needs time investment. But once the task has been completed and the format finalized it should be periodically updated.

On the whole, the scorecard improves the quality of Board's contribution and leads to more constructive engagement with the management. This makes for better governance and performance.

Significance of Enterprise Governance

A careful analysis of various scandals reveal that the focus of corporate governance has been only on a simple dimension i.e. conformance. Simply stated, the conformance failure was simply a failure of control. Therefore, the need is to adopt an integrated approach. Many of the recent failures were strategic failures where Board failed to prevent management from damaging long term shareholder value.

Economic Intelligence Unit Survey (2002) observed that "regulations are only a part of the answer to corporate governance". Companies must create value. Board must check for the appropriateness of strategy and its implementation. Making right decisions about wrong issues will take nobody nowhere.

Ernst & Young in a study (2002) of Global 1000 businesses over a five year period had discovered that two thirds of all radical share price movements are a direct consequence of strategic issues. Financial and operational risks account for only one third.

The enterprise governance mechanism thus enables companies and Boards to respond, and adjust to changing requirements as well as continually improve the efficiency of processes.

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Sub - Theme 3

Best Practices in Financial / Non-Financial Disclosures

INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS) — A GATE-WAY TO UNIVERSAL GLOBAL ACCOUNTING PRACTICES

M A JOSEPH*

INTRODUCTION

In the present era of globalization and liberalization the world has become a global village. The globalization of the business and the structures and regulations, which support it, as well as the development of e-commerce make it imperative to have a single globally accepted financial reporting system. A number of multinational companies have established their business in the emerging economies. Companies in the emerging economies are increasingly accessing the global market to fulfill their capital needs by getting their securities listed on the stock exchanges outside the country. Sound financial reporting has thus become imperative for economic well being and effective functioning of capital markets. As far as investors are concerned they want information which is reliable, relevant, timely and comparable across the countries. Financial statements prepared using a common set of accounting standards facilitate investors in better understanding of investment opportunities as opposed to those prepared under different sets of national accounting standards. With variations in the accounting standards from country to country, multinational organizations operating in different countries face multitude of accounting requirements prevailing in the respective countries. The adoption of International Financial Reporting Standards (IFRS), which endeavors to create a universal financial reporting standards implies that all accounting standards the world over conform to the same platform. International Financial Reporting Standards are now becoming universal reporting language. In tune with the global trend the Government of India has already expressed its intention to facilitate the convergence of the Indian Accounting Standards with IFRS by 1st April 2011. Like India many other countries such as Canada, Japan, South Korea, European Union, Australia, etc. International Financial Reporting Standards (IFRS) are rapidly becoming globally applied set of accounting standards, with over 100 countries now applying IFRS.

ORIGIN AND STRUCTURE OF IFRS

Since 1973 the International Accounting Standards Council (IASC) has been formulating International Accounting Standards (IAS) that have been accepted by many multinational companies and endorsed by many countries as their own standards. In 2001 the IASC was restructured and renamed as the International Accounting Standards Board (IASB). This Board adopted existing IAS and assumed the responsibility of setting new standards which came to be known as International Financial Reporting Standards. The main objective of the IASB is to develop a single set of high quality, understandable and enforceable global accounting standards to help participants in various capital markets and other users of information to make economic decisions. In the past, most nations developed their own local Generally Accepted Accounting Principles (GAAP). These along with other local laws and regulations determined how accountants would prepare financial statements. The advent of IFRS has brought with it the choice of adopting a globally accepted set of standards instead of using local GAAP.

* Deputy Director, The ICSI. The views expressed are personal views of the author and do not necessarily reflect those of the Institute.

International Financial Reporting Standards (IFRSs) comprise the following :

(a) International Financial Reporting Standards IFRS)-Standards issued after 2001

(b) International Accounting Standards (IAS)-Standards issued before 2001

(c) Interpretations originated from the International Financial Reporting Interpretations Committee (IFRIC)-issued after 2001

(d) Interpretations issued by Standing Interpretation Committee (SIC) - issued before 2001.

COMPONENTS OF FINANCIAL STATEMENTS UNDER IFRS

An entity's first IFRS financial statements must include at least figures of one comparative period. A complete set of financial statements include the following:

(i) A statement of financial position as at the end of the period:

This was earlier referred to as balance sheet. As a minimum, the statement of financial position shall include line items that present the following:

(a) property, plant and equipment;

(b) investment property;

(c) intangible assets;

(d) financial assets;

(e) investments;

(f) biological assets;

(g) inventories;

(h) trade and other receivables;

(i) cash and cash equivalents;

(j) the total of assets classified as held for sale;

(k) trade and other payables;

(l) provisions;

(m) financial liabilities

(n) liabilities and assets for current tax;

(o) deferred tax liabilities and deferred tax assets;

(p) liabilities included in disposal groups classified as held for sale;

(q) minority interest, presented within equity; and

(r) Issued capital and reserves attributable to owners of the parent.

An entity should make a distinction between current and non current assets and liabilities, except when the presentation based on liquidity provides information that is more reliable and relevant.

(ii) A statement of comprehensive income for the period:

All non-owner changes in equity to be presented in either (i) statement of comprehensive income or (ii) two statements, a separate income statement and a statement of other comprehensive income.

The following information should be disclosed on the face of the statement of comprehensive income, together with any additional headings or sub-totals as may be required or that may be required to give a fair presentation of the entity's performance:

(a) revenue;

(b) finance costs;

(c) share of the profit or loss of associates and joint ventures accounted for using the equity method;

(d) tax expenses;

(e) a single amount comprising the total of the post-tax profit or loss of discontinued operations and the post-tax gain or loss recognised on the disposal of the assets or disposal group(s) constituting the discontinued operation;

(f) profit or loss;

(g) each component of other comprehensive income classified by nature;

(h) each component of other comprehensive income of associates and joint venture accounted using equity method; and

(i) total comprehensive income.

The following items must also be disclosed on the face of the statement of comprehensive income as allocations of :

(a) profit or loss for the period i.e. profit or loss attributable to minority interest; and profit or loss attributable to equity holders of the parent.

(b) total comprehensive income for the period as comprehensive income attributable to minority interest and comprehensive income attributable to equity holders of the parent.

(iii) A statement of changes in equity for the period

An entity shall present a statement of changes in equity showing in the statement :

(a) total comprehensive income for the period, showing separately the total amounts attributable to owners of the parent and to non-controlling interests;

(b) for each component of equity, the effects of retrospective application or retrospective restatement; and

(c) for each component of equity, reconciliation between the carrying amount at the beginning and the end of the period, separately disclosing changes resulting from:

  (i) profit or loss;

  (ii) each item of other comprehensive income; and

  (iii) transactions with owners in their capacity as owners, showing separately contributions by and distributions to owners and changes in ownership interests in subsidiaries that do not result in a loss of control.

(iv) A statement of cash flows for the period

The statement of cash flows is an important primary statement. It shows a company's flow of cash. The statement of cash flows analyses changes in cash and cash equivalents during a period. Cash and cash equivalents comprise cash on hand and demand deposits, together with short-term, highly liquid investments that are readily convertible to a known amount of cash and that are subject to an insignificant risk of changes in value. Cash flows must be analysed between operating, investing and financing activities.

(v) Notes, comprising a summary of significant accounting policies and other explanatory information:

The notes must:

(a) present information about the basis of preparation of the financial statements and the specific accounting policies used;

(b) disclose any information required that is not presented on the face of the statement of financial position, statement of comprehensive income, statement of changes in equity, or cash flow statement; and

(c) provide additional information that is not presented on the face of the statement of financial position, statement of comprehensive income, statement of changes in equity, or cash flow statement that is deemed relevant to an understanding of any of them.

(vi) A statement of financial position as at the beginning of the earliest comparative period when an entity applies an accounting policy retrospectively.

CONVERGENCE WITH IFRS--CHALLENGES FOR INDIA

Convergence with IFRS may pose challenges in terms of varying legal and regulatory requirements related to financial statements, the technical preparedness of industry and professionals and economic environment prevailing in the country. For Indian companies transiting to IFRS from 2011 are required to make comparative statements for one preceding year and having financial year from April to March, the date of transition would be 1st April 2010 and for companies having financial year from January to December, date of transition would be 1st January 2010. The transition from Indian GAAP to IFRS is little complicated. This is so because of the complex procedures that we have currently in place and the aggressive timelines that require companies to prepare their first IFRS balance sheet. There are several impediments and practical challenges to the adoption of and full convergence of IFRS:

Complexity of accounting framework : In India there are multiple standard-setters i.e. NACAS (National Advisory Committee on Accounting Standards), Institute of Chartered Accountants of India, Securities and Exchange Board of India, Income Tax Authorities, Reserve Bank of India, Insurance Regulatory and Development Authority, etc. A smooth transition calls for a concerted effort on their part to coordinate their plans and to create an understandable accounting landscape that will prevail in 2011.

Fair value measurements : IFRS requires application of fair value principles in certain situations and this would result in significant differences from financial information currently presented, especially relating to financial instruments and business combinations. Indian companies will have to build awareness amongst investors and analysts to explain the reasons for this volatility in order to improve understanding, and increase transparency and reliability of their financial statements. IFRS are principles-based standards but they offer certain accounting policy choices to preparers of financial statements. However, the responsibility for enforcement and providing guidance on implementation vests with Central Government and accounting and regulatory bodies. Consequently, there may be differences in interpretation or practical application of IFRS provisions, which could further reduce consistency in financial reporting and comparability with global peers.

Amendments in Laws and Regulations : There is a need for changes in many related laws and regulations governing financial accounting and reporting in India. In addition to accounting standards, there are legal and regulatory requirements that determine the manner in which financial information is reported or presented in financial statements. As per the preface to the Indian Accounting Standards, if a particular accounting standard is found to be not in conformity with a law, the provisions of law will prevail and the financial statements shall be prepared in conformity with such law. Under IFRS, the entity needs to comply with all the accounting standards and other authoritative guidelines/ interpretations issued by IASB.

Company Law : Schedule VI of the Companies Act, 1956, prescribes the format for presentation of financial statements for Indian companies, whereas the financial presentation requirements under IFRS are significantly different.

Income Tax Act 1961 : The Income Tax Act does not recognize the accounting standards for most of the items while computing income under the head "Profits and Gains of Business or Profession". Section 145(2) of the Income Tax Act has empowered the Central Government to prescribe separate accounting standards. Convergence with IFRS will require significant changes/clarifications from the tax authorities on treatment of various accounting transactions.

Other Regulations : The Reserve Bank of India intervenes in the financial reporting for banks and other financial institutions, including the presentation format and accounting treatment, etc. The Insurance Regulatory and Development Authority regulates the financial reporting of insurance companies. The Foreign Exchange Dealers' Association of India (FEDAI) provides guidelines regarding accounting for foreign exchange transactions.

Up gradation and conversion of accounting system : Many Indian companies are having legacy financial systems that will need to be evaluated to determine whether they are capable of handling the transition process. For many organizations, the conversion to IFRS will be a multi-year exercise with numerous changes to technology infrastructure and systems. Since rollouts of new systems must be coordinated to avoid conflict with changes to the accounting systems, project coordination between technology and accounting will be essential. Further, the historical data from recent prior periods will have to be recast for comparative purposes. This is necessary to present accurate and comparative statements and trend and ratio analysis.

ADVANTAGES OF ADOPTION OF IFRS

Adoption of IFRS by Indian corporate is going to be rewarding one. Indian companies are likely to reap significant benefits from adopting IFRS. It is expected to result in better quality of financial reporting due to consistent application of accounting principles and improvement in reliability of financial statements. This, in turn, will lead to increased trust and reliance placed by investors, analysts and other stakeholders in a company's financial statements. As the CFO of today is confronted with the challenge of multitude of reporting under different accounting frameworks, a single set of robust and well-understood standards would be far more effective in promoting high-quality financial reporting.

The convergence with IFRS would not only save companies undertaking significant reconciliation procedures, which otherwise results in additional costs and the risk of being exposed to errors in reporting under the different accounting frameworks.

Enhanced Credibility of Financial Statements

The adoption of IFRS will enhance the credibility of the company's financial statements and will provide easy access to foreign capital. It would benefit the economy by increasing growth of its international business and at the same time would facilitate maintenance of orderly and efficient capital markets which helps to increase the capital formation leading to economic growth. As a result, it would encourage international investing which leading to more foreign direct investment in the country. A recent decision by the US Securities and Exchange Commission (SEC) permits foreign companies listed in the US to present financial statements in accordance with IFRS. This means that such companies will not be required to prepare separate financial statements under Generally Accepted Accounting Principles in the US (US GAAP). Therefore, companies listed in the US would benefit from having to prepare only a single set of IFRS compliant financial statements, and the consequent saving in financial and compliance costs. The industry will be able to raise money from foreign markets provided they enjoyed confidence of foreign investors that their financial statements comply with globally accepted accounting standards.

Enhanced Comparability of Financial Information

High quality global financial reporting standards enhance the comparability of financial information. They improve the efficiency of allocation and the pricing of capital. It benefits not only those who provide debt or equity capital but also those that seek capital, because it reduces their compliance costs and removes uncertainties that affect the cost of capital.

The convergence of accounting standards would eliminate costs of multiple sets of accounting and provide greater opportunities for professionals around the globe. Converging of entire world towards IFRS will throw open entire new area of opportunities for professionals throughout world more so for professionals in country like India.

The adoption of IFRS is expected to result in better quality of financial reporting due to consistent application of accounting principles and improvement in reliability of financial statements. This, in turn, will lead to increased trust and reliance placed by investors, analysts and other stakeholders. Superior financial reporting could be useful in convincing a firm's present and potential employees of its financial soundness, so that as key users of firm's accounting information they can trust the firm as a dependable employer. The rising use of pay for performance plans and the need for international tradability of employees stocks and stock options further underscore the need for respectable accounting rules.

ADOPTION OF IFRS—POSITION IN SELECT COUNTRIES

IFRS are being used in various jurisdictions, including the European Union, Hong Kong, Australia, Malaysia, Pakistan, GCC countries, Russia, South Africa, Singapore, Turkey, South Korea, etc. Let us examine the progress in select countries :

Australia

The Australian Accounting Standards Board (AASB) has issued 'Australian equivalents to IFRS' (A-IFRS), numbering IFRS standards as AASB 1-8 and IAS standards as AASB 101 - 141. Australian equivalents to SIC and IFRIC Interpretations have also been issued, along with a number of 'domestic' standards and interpretations. These pronouncements replaced previous Australian Generally Accepted Accounting Principles with effect from annual reporting period beginning on or after 1 January 2005. To this end, Australia, along with Europe and a few other countries, was one of the first countries to adopt IFRS. The AASB has made certain amendments to the IASB pronouncements in making A-IFRS; however these generally have the effect of eliminating an option under IFRS, introducing additional disclosures or implementing requirements for not-for-profit entities, rather than departing from IFRS for Australian entities. The AASB continues to reflect changes made by the IASB as local pronouncements. In addition, over recent years, the AASB has issued so-called 'Amending Standards' to reverse some of the initial changes made to the IFRS text for local terminology differences, to reinstate options and eliminate some Australian-specific disclosure.

Canada

The Canadian Accounting Standard Board ensures the use of IFRS for Canadian publicly accountable profit-oriented enterprises for financial periods beginning on or after January 1, 2011. This includes public companies and other profit-oriented enterprises that are responsible to large or diverse groups of shareholders.

European Union

All listed EU companies have been required to use IFRS since 2005. In order to be approved for use in the EU, standards must be endorsed by the Accounting Regulatory Committee (ARC), which includes representatives of member state governments and is advised by a group of accounting experts known as the European Financial Reporting Advisory Group. As a result IFRS as applied in the EU may differ from that used elsewhere. Parts of the standard IAS 39: Financial Instruments: Recognition and Measurement were not originally approved by the ARC. IAS 39 was subsequently amended, removing the option to record financial liabilities at fair value, and the ARC approved the amended version.

South Korea

The Korea Accounting Institute has released the Korean translation of International Financial Reporting Standards as a part of a plan announced in March 2007 by the Korea Accounting Institute and Korean Financial Supervisory Commission, for adopting Korean equivalents of IFRS (K-IFRS). All listed companies will be required to prepare their annual financial statements under K-IFRS beginning in 2011. Listed companies other than financial institutions are however required to do so from 2009.

Russia

The government of Russia has been implementing a program to harmonize its national accounting standards with IFRS since 1998. Since then twenty new accounting standards have been issued by the Ministry of Finance of the Russian Federation aiming to align accounting practices with IFRS. Since 2004 all commercial banks have been obliged to prepare financial statements in accordance with both national accounting standards and IFRS. Full transition to IFRS is expected to take place from 2011.

Hong Kong

Starting in 2005, Hong Kong Financial Reporting Standards (HKFRS) are identical to International Financial Reporting Standards. There is one Hong Kong standard and several Hong Kong interpretations that do not have counterparts in IFRS. Also there are several minor differences between HKFRS and IFRS.

Singapore

In Singapore, the Accounting Standards Committee (ASC) is in charge of standard setting. Singapore closely models its Financial Reporting Standards (FRS) according to the IFRS, with appropriate changes made to suit the Singapore context. Before a standard is enacted, consultations with the IASB are made to ensure consistency of core principles.

United States of America

At Norwalk agreement in 2002, the IASB and the US Financial Accounting Standards Board (FASB) agreed to harmonize their agenda and work towards reducing differences between IFRS and US GAAP. In February 2006 FASB and IASB issued a Memorandum of Understanding including a program of topics on which the two bodies would seek to achieve convergence by 2008. US companies registered with the United States Securities and Exchange Commission must file financial statements prepared in accordance with US GAAP. Until 2007, foreign private issuers were required to file financial statements prepared either (a) under US GAAP or (b) in accordance with local accounting principles or IFRS with a footnote reconciling from local principles or IFRS to US GAAP. This reconciliation imposed the companies extra cost which are listed on exchanges both in the US and another country. From 2008, foreign private issuers are additionally permitted to file financial statements in accordance with IFRS as issued by the IASB without reconciliation to US GAAP. In August 2008, the SEC announced a timetable that would allow some companies to report under IFRS as soon as 2010 and require it of all companies by 2014.

Japan

The Accounting Standards Board of Japan has agreed to resolve all inconsistencies between the current JP-GAAP and IFRS by 2011.

CHECKLIST FOR ADOPTION OF IFRS

The following approach may be considered to resolve the issues involved in adoption of IFRS :

(i) Utilize all available sources for building the company's knowledge of international accounting standards. After establishing a basic competency in IFRS, prepare a summarization of how the new standards apply in the organization. Every company has its own needs and culture and the transition methodology can be tailored to the organization specific requirements. All companies carry out a diagnostic review to assess the IFRS impact on financial reporting, long-term contracts, supporting business processes, information systems, tax compliance and employee benefits. This is done to equip businesses with a better sense of what changes would be required and how much time and resources would go into ensuring a smooth transition.

(ii) Setting up an IFRS conversion project which involves designing of conversion strategy, establishment of IFRS accounting policies, carrying out operational and systems changes, and eventually coming out with the first comprehensive IFRS financial statement.

(iii) Efforts should be made to integrate IFRS changes in day to day operations, processes, systems and controls. Involvement of IT professionals to be ensured.

(iv) Judge the potential of IFRS knowledge in the organization. It could come from several sources-new employees with multinational experience, international-based executives, global partners or recently qualified professionals.

(v) Prepare preliminary IFRS based financial statements. Compare them with current GAAP financials. Calculate key ratios and metrics under both methods.

(vi) Critically examine the results of comparative analysis. Identify possible changes in strategic objectives or immediate operational activities.

(vii) Use the transition to IFRS as an opportunity for streamlining the accounting operations.

CONCLUSION

Convergence to IFRS would mean India would join a league of more than 100 countries, which have converged with IFRS. But, Indian Accounting Standards have yet to be kept pace with changes in IFRS. There are significant differences between IFRS and Indian GAAP, because Indian standards remain sensitive to local conditions, including the legal and economic environment. Full convergence would be a welcome step and it should happen early. The decision to converge with IFRS has major public policy implications and will particularly impact India’s systems of accounting and disclosure, corporate governance policies, tax/company law and securities law regulations. Convergence to IFRS by Indian corporate is going to be very challenging but at the same time could also be rewarding and Indian corporate is likely to reap significant benefits from adopting IFRS.

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BEST PRACTICES IN DISCLOSURES ON GOOD CORPORATE GOVERNANCE

CS SAURABH JAIN*

The fall of once too large to fail organizations from the corporate horizon has shaken the investor confidence and raised fundamental issues as to their corporate governance policies, and practices. As investors have now access to performance of a company on its governance, the governance considerations assume a trigger to avoid investing in misgoverned companies. On the other hand there are evidences to show that investors pay a premium over the face value of securities of companies that are visibly well governed. A Standard & Poor's study on transparency and disclosure suggests that companies that voluntarily disclose more than is required may command a higher stock price and that such additional disclosure may be a best practice.

Jane McCahon, Conway Communications and former chairperson of the National Investor Relations Institute, Vienna (NIRI) suggests, "Nothing gets more personal than the composition of a company's board of directors or its compensation policies, but given the level of cynicism in the marketplace today, we should be taking extra steps to make sure the investment community has easy access to all that information. Companies that proactively disclose such information will be rewarded in the long term; those that don't – or worse yet, attempt to bury corporate governance information – will be punished."

Doing good business is important, but even more important is how corporates communicate to their shareholders and stakeholders on various financial, non-financial and corporate governance matters. To remain credible, companies need to make various kinds of information readily accessible and focus their efforts on providing clear and concise reports possibly in the most transparent manner.

Internet holds immense possibilities to bring visibility to the corporate governance policies of a company. An effective corporate portal with a section dedicated to corporate governance can promote corporate integrity and help in building investor confidence. Corporate Governance is not a one-size fits all proposition – it has to be tailor made to suit the organisation's requirements of presenting the information in a easy-to-use and easy-to-access format, while at the same time maintaining transparency.

The best practices on disclosures related to structure, role and functions of the board, based on a study of the Reports of the Committees on Corporate Governance, Codes on Corporate Governance and websites of some of the best governed companies, have been discussed in the following paragraphs.

COMPOSITION OF THE BOARD

Clause 49 of the listing agreement provides that the Board of Directors of the company shall have an optimum combination of executive and non-executive directors with not less than fifty percent of the board of directors comprising non-executive directors. Where the Chairman of the Board is a non-executive director, at least one-third of the Board should comprise of independent directors and in case he is an executive director, at least half of the Board should comprise of independent directors.

* Education Officer, The ICSI. The views expressed are personal views of the author and do not necessarily reflect those of the Institute.

The UNCTAD – Guidance on Good Practices in Corporate Governance Disclosure provides that, "The composition of the board should be disclosed, in particular the balance of executives and non-executive directors, and whether any of the non-executives have any affiliations (direct or indirect) with the company. Where there might be issues that stakeholders might perceive as challenging the independence of non-executive directors, companies should disclose why those issues do not impinge on the governance role of the non-executive directors as a group."

The third Report on Governance in South Africa (King III) provides that, "The board should comprise a balance of executive and non-executive directors, with a majority of non-executive directors; The board should be led by an independent non-executive chairman who should not be the CEO of the company; The board should appoint an effective and ethical chief executive officer."

UK Combined Code on Corporate Governance provides that, "Every company should be headed by an effective board, which is collectively responsible for the success of the company. There should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company's business. No one individual should have unfettered powers of decision." The Code further provides that, "the board should include a balance of executive and non-executive directors (and in particular independent non-executive directors) such that no individual or small group of individuals can dominate the board's decision taking."

There is an issue relating to division of responsibilities between chairman and managing director. In this context, the Cadbury Committee Report places stress on the need for a clear division of responsibilities between the chairman and the chief executive officer (para. 4.9) If the roles of the chairman and CEO are combined, the proportion of independent directors within the board structure assumes greater importance. For example, the Cadbury Report and the Kumar Mangalam Birla Committee Report on Corporate Governance, 2002 recommend that where the roles of Chairman and CEO were combined, there should be a strong independent element on the board and that there should be a lead non-executive director to whom issues regarding the executive management could be addressed.

Another issue is determination of independence. Not all non-executive directors can be considered independent directors. The Narayana Murthy Committee made a clear distinction between non-executive and independent directors. The Committee observed that nominees appointed by the banks and financial institutions on the Board of companies financially assisted by them although non-executive directors cannot be considered independent. Similarly, in case of non-executive directors appointed on the board of subsidiary companies who draw remuneration from the parent company in their capacity as employee of that company cannot be said to be independent directors in relation to such subsidiary company. Thus, any relationship of directors to the parent company or its subsidiaries or to any other financial institution or otherwise should be disclosed as such a relationship could be considered in assessing the ability of the non-executive director to fulfill his or her duties.

ROLE AND FUNCTIONS OF THE BOARD

The UNCTAD – Guidance on Good Practices in Corporate Governance Disclosure lays stress on disclosure of the role and functions of the Board. Various codes on Corporate Governance the world over distinguish the role and functions of the board from the responsibilities of the management. For example, the King II Report (South Africa) specifies board functions as management selection, oversight and compensation for senior management, succession planning, communications with shareholders, integrity of financial controls and general legal compliance.

The third Report on Governance in South Africa (King III) lays down the following principles in respect of role and functions of the board - "1.The board should act as the focal point for corporate governance; 2. The board should ensure that the company acts as and is seen to be a responsible corporate citizen; 3. The board should cultivate and promote an ethical corporate culture; 4. The board should appreciate that strategy, risk, performance and sustainability are inseparable; 5. The board should consider sustainability as a business opportunity; 6. The board should appoint the chief executive officer and establish a framework for the delegation of authority; 7. The board should be responsible for the process of risk management; 8. The board and its directors should act in the best interests of the company; 9. The board and its directors should manage conflicts of interest; 10. The board should ensure that there is an effective risk-based internal audit; 11. The board should ensure the integrity of financial reporting; 12. The board should report on the effectiveness of internal financial controls; 13. The board should ensure that the company makes full and timely disclosure of material matters concerning the company; 14. The board should ensure that internal and external disputes are resolved effectively, expeditiously and efficiently; 15. The board should ensure that the company implements an effective compliance framework and processes; 16. The board should commence business rescue proceedings as soon as the company is financially distressed."

Thus, it becomes imperative for the company to clearly disclose the role and functions of the Board and the powers, functions and duties of the Board delegated to the Managing Director / Manager. A clear demarcation between the Management and the Board if their exists in the company should also be highlighted with specific listings of the role and functions of each one of them.

BOARD COMMITTEES

The formation of Board Committees, among others, enhances independent judgement on matters where there is potential for conflict of interest. It also brings special expertise in areas such as audit, risk management, appointment and remuneration of board members and senior management.

The UNCTAD – Guidance on Good Practices in Corporate Governance Disclosure provides that, "Governance structures should be disclosed. In particular, the board should disclose structures put in place to prevent conflicts between the interests of the directors and management on the one side, and those of shareholders and other stakeholders on the other. The composition and functions of committees should be fully disclosed. Committee charters, terms of reference or other company documents outlining the duties and powers of the committees or its members should also be disclosed, including whether or not the committee is empowered to make decisions which bind the board, or whether the committee can only make recommendations to the board. Where any director has taken on a specific role for the board or within one of these structures, this should be disclosed."

The third Report on Governance in South Africa (King III) lays down that, "The board should delegate certain functions to well-structured committees without abdicating its own responsibility."

Clause 49 of the Listing Agreement provides for the formation of three mandatory committees, viz., Audit Committee, Remuneration Committee and Shareholders Committee apart from a host of other committees which the Board may at its discretion deem necessary in order to carry out its functions effectively.

Good disclosure practices require disclosure of the committee charters or terms of reference, committee chairs, reports on activities (in particular those of the audit committee), composition, meetings and attendance during the year. With particular reference to the remuneration committee, the company should disclose its remuneration policy and the details of remuneration to all directors. As regards the shareholders committee, disclosure should be made regarding the name and designation of the compliance officer, details (nos.) of shareholders' complaints received so far, number of complaints not redressed to the satisfaction of shareholders and number of pending complaints.

As a matter of good practice the company may provide a table classifying the shareholder complaints on the basis of nature of such complaints, and also provide some sort of frequently asked questions to sort out general shareholder complaints. It would not be out of place to state that the company may provide a mechanism on its website to enable the shareholders to place their complaints online which can provide them an easy access to track their complaints and to know the status of their complaints. Further, the company may provide a toll free help line number, where the shareholders can call and register their complaints for speedy redressal. An online chat facility for redressal of investor complaints with the compliance officer directly replying to the complaints / queries of the shareholders is fast becoming popular now-a-days.

MEMBERS OF THE BOARD AND KEY EXECUTIVES

Gone are the days of the simply listing the names of senior management and board of directors. Today, companies are not shy of providing biographical information and photograph accompanied by the individual's committee responsibilities, an indication to whether or not they are "independent", and details of other directorships held.

The UNCTAD – Guidance on Good Practices in Corporate Governance Disclosure provides that, "The number, type and duties of board positions held by an individual director should be disclosed. An enterprise should also disclose the actual board positions held, and whether or not the enterprise has a policy limiting the number of board positions any one director can hold.

There should be sufficient disclosure of the qualifications and biographical information of all board members to assure shareholders and other stakeholders that the members can effectively fulfill their responsibilities. There should also be disclosure of the mechanisms which are in place to act as "checks and balances" on key individuals in the enterprise."

ETHICS POLICY AND SUPPORT STRUCTURE

Ethical practices are essential component of good business practices, transparency and risk mitigation. Clause 49 of the Listing Agreement requires that the board shall lay down a code of conduct for all Board members and senior management of the company, and that the code of conduct shall be posted on the website of the company.

The UNCTAD – Guidance on Good Practices in Corporate Governance Disclosure requires, "The existence of an enterprise code of ethics and that any governance structure put in place to support that code of ethics should be disclosed. Any waivers to the code of ethics or the rules governing ethics procedures should also be disclosed."

It would therefore be good disclosure to mention the details of the ethics officer and his responsibilities; the existence of an ethics committee and its relationship to the board; policies for breach of the ethics code, including reporting mechanisms and "whistleblower" protection mechanisms; and policies on the dissemination and promotion of the ethics code. A link may be provided to the company's Code of Conduct / Ethics Policy for Directors as updated from time to time.

DIRECTORS TRAINING AND DEVELOPMENT

The Naresh Chandra Committee on Corporate Audit and Governance has recommended training for independent directors and disclosure thereof. The UNCTAD – Guidance on Good Practices in Corporate Governance Disclosure provides that, "There should be disclosure of the types of development and training that directors undergo at induction as well as the actual training directors received during the reporting period. The board should disclose facilities which may exist to provide members with professional advice. The board should also disclose whether that facility has been used during the reporting period."

The Combined Code on Corporate Governance provides, "The board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties. All directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge."

The third Report on Governance in South Africa (King III) recommends that, "Training and development of directors should be conducted through formal processes."

Best practices suggest that the company should make adequate disclosure of the directors induction and other training programmes in addition to the disclosure of other professional assistance mechanisms developed by the company to enable its independent directors to carry out their duties effectively.

EVALUATION MECHANISM

In addition to the duties and responsibilities of directors, shareholders today demand information on directors evaluation with particular reference to their performance. The Listing Agreement requires disclosure of the frequency and procedures of the meetings of the board and the committees thereof and the attendance at such meetings.

The UNCTAD – Guidance on Good Practices in Corporate Governance Disclosure suggests that, "The board should disclose whether it has a performance evaluation process in place, either for the board as a whole or for individual members. Disclosure should be made as to how the board has evaluated its performance and how the results of the appraisal are being used."

The Combined Code on Corporate Governance provides, "The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors."

The third Report on Governance in South Africa (King III) recommends that, "The performance of the board, its committees and the individual directors should be evaluated annually."

As a matter of good practice, specific disclosure should be made of the number of board meetings and committee meetings held during the reporting period and the maximum time gap between any two meetings. In addition attendance details of meetings attended by the directors should also be given. The requirements as to quorum for each meeting and whether the quorum was present at the meeting should also be stated. In addition to that the disclosure be also made in relation to methods and parameters for performance evaluation of board collectively and its members individually.

DIRECTORS' REMUNERATION

UK Combined Code on Corporate Governance requires that, "Levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the company successfully, but a company should avoid paying more than is necessary for this purpose. A significant proportion of executive directors' remuneration should be structured so as to link rewards to corporate and individual performance.

There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration. "

The third Report on Governance in South Africa (King III) provides that, "Companies should remunerate fairly and responsibly; Companies should disclose the remuneration of each individual director; The remuneration committee should issue a remuneration report to explain the company's remuneration philosophy and how it has been implemented; Shareholders should approve the company's remuneration policy."

Clause 49 of the Listing Agreement enumerates the disclosures to be made on the remuneration of directors in the section on corporate governance of the Annual Report, these include, all elements of remuneration package of individual directors summarized under major groups, such as salary, benefits, bonuses, stock options, pension, etc.; Details of fixed component and performance linked incentives, along with the performance criteria; Service contracts, notice period, severance fees; Stock option details, if any – and whether issued at a discount as well as the period over which accrued and over which exercisable.

Further, the company is required to publish its criteria of making payments to non-executive directors in its annual report. A company is to disclose the number of shares and convertible instruments held by non-executive directors in the annual report. Non-executive directors are required to disclose their shareholding (both own or held by / for other persons on a beneficial basis) in the listed company in which they are proposed to be appointed as directors, prior to their appointment.

As regards, disclosure of Director's remuneration, the UNCTAD – Guidance on Good Practices in Corporate Governance Disclosure provides, "Directors should disclose the mechanism for setting directors' remuneration and its structure. A clear distinction should be made between remuneration mechanisms for executive directors and non-executive directors. Disclosure should be comprehensive to demonstrate to shareholders and other stakeholders whether remuneration is tied to the company's long-term performance as measured by recognized criteria. Information regarding compensation packages should include salary, bonuses, pensions, share payments and all other benefits, financial or otherwise, as well as reimbursed expenses. Where share options for directors are used as incentives but are not disclosed as disaggregated expenses in the accounts, their cost should be fully disclosed using a widely accepted pricing model.

The length of directors' contracts and the termination of service notice requirements, as well as the nature of compensation payable to any director for cancellation of service contract, should be disclosed. A specific reference should be made to any special arrangement relating to severance payments to directors in the event of a takeover."

Best practice demands that details of remuneration paid to individual directors should be presented in a tabular form under different headings. With increased attention being laid on insider trading, it would all the more be appropriate to provide information on insider transactions and related party transactions.

SUCCESSION PLANNING

OECD Principle (IV.D.2) stresses that overseeing succession planning is a key function of the board. While specific details regarding potential successors might be the subject of confidentiality, the existence of a procedure and a preparedness to appoint successors as necessary is not confidential, and should be the subject of disclosure.

The UNCTAD – Guidance on Good Practices in Corporate Governance Disclosure provides, "The board should disclose whether it has established a succession plan for key executives and other board members to ensure that there is a strategy for continuity of operations."

As a good practice, the company may disclose the guiding principles for preparing the succession plan and the level of management for which it has a succession plan in place.

CONFLICT OF INTEREST

Section 299 of the Companies Act, 1956 provides for disclosure of interest by a director. Further, such directors shall not participate in the discussions relating to transactions in which they are interested, nor shall they participate in voting on the matter. The UNCTAD – Guidance on Good Practices in Corporate Governance Disclosure requires, "Conflicts of interest affecting members of the board should, if they are not avoidable, at least be disclosed. The board of directors should disclose whether it has a formal procedure for addressing such situations, as well as the hierarchy of obligations to which directors are subject."

Thus, the company should disclose all conflicts of interest, along with what the board decided to do regarding the specific situation and the relevant director involved along with the nature of his/her interest.

CG HIGHLIGHTS

A good corporate governance section should be designed not just to provide what is required by law, but should foresee and provide what investors may be looking for. The huge matrix of possibilities that the Internet offers can help a company to make it easy for investors to find and use information while at the same time meeting the legal requirements. The "highlights" section of the corporate governance webpage may list the key issues for investors and act as a launch pad of links to important information. It allows the company to emphasize the initiatives that illustrate the company's specific commitment to good corporate governance. The companies can use this page to highlight information that is important to the investors and make it easier for the investors to access it. Data can be provided in summarized form in tables and graphs or any other pictorial representation so that the investors can quickly and easily digest the information. Further links may be provided to enable the investors to carry out detailed research on the topic of their interest.

The CEO/CFO Certifications as envisaged in the Listing Agreement may also be provided as a link under this section. It is also a good practice to provide the corporate values along with its vision and mission statements under this head.

FAQ'S ON CORPORATE GOVERNANCE

Some FAQ's on Corporate Governance may also be included as part of the disclosure exercise. Typically such questions may include the following:

— How are directors compensated ?

— What is the current management compensation ?

— What were the changes in directorships during the current year ?

— What is the level of management ownership ?

— What happens if the management team leaves ?

— Who is the compliance officer ?

— Who are the chairmen and secretary of the various committees of the Board ?

— Whom should a shareholder contact for redressal of his grievances ?

— How much time does it take for action on a grievance filed by a shareholder ?

— How does the company fulfill its social responsibility statement ?

— What measures has the company taken for energy conservation ?

— Where can I find information about the company ?

— Where can I find information about the Company's executives ?

— How many directors serve on the company's Board of Directors ?

— Are the roles of Chairman and Chief Executive Officer split or combined at the company ?

— Does the company have a Lead Independent Director ?

— What is the function of the Lead Independent Director ?

— How many of the company's directors are independent ?

— Are the company's Board committee members independent ?

— Who is the company's statutory auditor? How often do audit personnel rotate ?

— Who should I contact if I have a question or concern about the company's internal accounting controls, an accounting matter, or an auditing matter ?

— How do I contact members of the company's Board of Directors ?

E-MAIL ALERTS

E-mailing has emerged as an almost no cost option for the corporates to communicate with the shareholders. It is a good practice to notify the shareholders on corporate governance issues through email in addition to hosting such disclosures on the company's website.

CONCLUSION

Corporate Governance disclosure of any kind needs transparency of the highest order. Any number of fancy decorations or presentation templates would be useless if the transparency norms are not met. There can be no set code for Corporate Governance disclosure and this has to be a voluntary exercise on the part of corporates. Effective disclosure demands knowledge and understanding of the reporting obligations both by those required to provide and prepare the information and by those entitled to receive such information. A balance between standardization and accommodation of specific company need is also required, as it aids discipline in reporting and allow for comparability and credibility. Disclosures enable companies to take stock of their position in the market place, as well as to encourage more informed and better quality decision making and finally to improve corporate behaviour and behaviour of those acting within the company or to maintain best practices. The above is only an outline of the basic skeleton to act as a guidance for corporates aiming at designing their disclosure documents and websites. By following the best practices outlined above, the companies can ensure complete and transparent disclosure of important information concerning their corporate governance practices.

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EVOLVING ROLE OF CORPORATES IN SOCIETY – TRENDS IN NON-FINANCIAL DISCLOSURES

KHUSBU AGRAWAL*

FROM "BEYOND THE NUMBERS"- KPMG 2000

"Companies are recognizing that failure in many non-financial areas can heavily damage the bottom lines, perhaps irreparably"

"Because most general business risks derive from non-financial factors, organizations have found that how they manage those business risks can influence their financial success"

The corporate landscape is changing as a result of the spatial expansion and social deepening of process of globalization. Globalization is increasing the degree of complexity in the business world. So it becomes inevitable for companies to have clearly defined business practices with a sound focus on social interest. In recent years, the concept of corporate social responsibility has gained prominence from all avenues.

NON-FINANCIAL DISCLOSURES

Leading companies are beginning to build stakeholder trust and simultaneously improve their business performance by measuring and reporting on both financial and non-financial indicators related to issues such as environmental management, worker relations and social responsibility. In fact, they are creating a new kind of competitive advantage by linking value and values, to position themselves as the companies of choice among customers, employees, investors, suppliers, business partners and local communities.

Corporate social responsibility (CSR) is an umbrella term under which the ethical rights and duties exist between companies and society. Corporate Social responsibility, in simple words, is corporates giving back something to the society in which they operate. According to the European Commission, "CSR is a concept whereby companies integrate social and environmental concerns in their business operations and in interaction with their stakeholders on a voluntary basis." World Business Council has defined it in the following way: "Corporate social responsibility is the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large".

CSR essentially considers business organizations as responsible citizens who live in a symbiotic relationship with the other elements within the social spectrum. It therefore means, just as organizations receive benefits from the society – they also have obligations towards society. The National Association of Accountants (NAA) Committee on Accounting for Corporate Social Performance described the term 'Corporate Social Performance' as "The term corporate social performance reflects the impact of a corporation's activities on society. According to K Davis, Society grants eligibility and power to business.

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In the long run, those who do not use power in a manner which society considers responsible will tend to lost it. Vigorous research on the topics of Corporate Social Responsibility and Corporate Social Performance has been taken in recent times. The corporate needs the society to carry on business. Social support is essential for development of a business. No business can grow with out society's support.

As an important part of the society, corporate has to carry some social activities. The NAA Committee on Accounting for Corporate Social Performance identified four major areas of social performance, as under-

(a) *Community Development* : Activities that is basically beneficial to the general public. For example, activities of housing construction, food programme, community planning and improvement etc. by a corporate would be treated as community development.

(b) *Human resources* : It includes social performance directed towards the well-being of employees. Training programme, up gradation of employees, improvement of working conditions, promotion policies and provision of job enrichment etc. would be treated as corporate social performance towards human resource.

(c) *Physical Resources and Environmental Contributions* : Activities by the corporate to prevent environmental deterioration or pollution, corporate activities towards prevention of air, water or noise pollution, conservation of scarce resources and the disposal of solid waste would be treated as physical resources and environmental contributions.

(d) *Product or Service Contributions* : This includes consumerism, product quality, packing, advertising, warranty provisions etc.

With performing for social welfare, it is also very much important to disclose performance in their annual report. Disclosure of social performance by a corporate has multiple effects. Corporate performance discloser is being evaluated as a culture of 'doing the right thing'.

Argentina, Australia, Britain and Canada are some of the countries which, in conjunction with business enterprises, adopted the measurement of CSR based on agreed parameters, such as, corporate vision and mission, labour conditions, accountability and transparency, quality of stakeholder relations, accuracy, relevance and reliability of information, concern for environmental protection, product safety, redressal of complaints and grievances, and funding of projects of vital social importance relating, for instance to, education, health, sanitation, disease prevention, basic amenities and so on.

Nature of Corporate social performance in India has also been changed and is being changed over the years. Before independence, the corporate sector was dominated by British firms with very few corporate of Indian origin. The companies had hardly any social relevance. After independence, social performance was only the part of government organizations. Mainly Public Sector units were looking after social activities. But since 1990-91, due to new economic policy adopted by Govt. of India, many foreign and global business units has entered in India. Competition among the corporate bodies has also been increased. It leads the corporates to undertake some sort of social activities to get loyalty of the customers. However, due to global affect, awareness about social responsibility has also been increased among the corporate bodies. The objective of a business as 'to sale goods or product' has been changed 'to 'satisfy customers'. So, corporate perspective towards society has also changed. Now in India, many of the big corporate houses contribute lots of money towards society. Indian corporates has taken legitimate pride in taking CSR along directions which are germane to the needs of society. It was heartening to know of examples of corporates working for farmer development, raising livelihood standards of rural communities, harnessing micro-enterprises to increase the penetration of consumer products in rural markets and coming out with software as aids to teachers and pupils to improve educational standards and promote adult literacy.

Non-financial disclosures

Annual report containing information about company's financial health, products and initiatives, represent the image of the company and is commonly used by investors, shareholders, stakeholders and public at large. It is necessary for the company to provide its information to fulfill their needs and build their own style of company image, since annual report represents the company and the company would like to be attractive to the all stakeholders. Information contained in the company's annual report consists of both mandatory and voluntary information. The mandatory disclosures of financial information are frequently integrated with non- financial Information, often disclosed voluntarily. Traditionally the financial disclosures provided by the companies include the financial statements, footnotes, management discussion and analysis and other regulatory filings. However, this is slowly changing and moving towards any other complementary reporting initiative: sustainability, environmental and social reports.

Trends in non-financial disclosures

Reporting of relevant and material non-financial information is an essential part of the disclosure required to enable shareowners and investors to make informed investment decisions. 'Non-financial' term refers to information relevant to the assessment of economic value, but which does not fit easily into the traditional accounting framework. Non-financial business reporting is a wide-ranging term which can include both regulated and voluntary disclosure by companies. From a shareowner and investor perspective, it is information, other than financial statements, which is relevant and material to investment decision making. This may include descriptive information around a company's operation and strategy or other disclosures which may bear on intangible assets and value drivers, and the company's "social license to operate". In a fast-changing globalising world, information material to investor decision-making is becoming increasingly diverse and dynamic. Long term success in managing a business in today's complex economic, environmental and social landscape is increasingly dependent on factors not reflected in financial statements and in some instances thought to be outside the corporation's sphere of concern. The same is true for investors when assessing a company's present and future valuation and ability to understand its opportunities and risks. For example, until recently, climate change drew little attention among investors and financial analysts. Non-financial business reporting contributes to achieving the objectives of disclosure and transparency.

Non financial business information when combined with financial information can provide valuable insight into the overall quality of management, a critical variable in the appraisal of company's financial prospects. Non-financial issues that may be material include: the impact of environmental risk, such as climate change; matters affecting employees, customers, suppliers and host communities; the development and protection of intellectual property and other intangible assets which are crucial to success; ethics, and governance arrangements.

Financial Disclosures vis-a-vis Non Financial Disclosures

Conventional financial disclosure primarily describes what has already occurred, for example, revenues, net earnings and depreciation of assets during a specified time period. These are essential to understand a company's financial results and condition at a point in time. On the other hand Non-financial disclosures can help inform the investment process by revealing in both quantitative and qualitative terms those drivers that increasingly shape company performance. It is increasingly recognised that relationships with key stakeholder groups including customers, employees, and communities can affect the company's financial performance and future value. In other words, an intangible business value, positive or negative, may be attributed to a company's relationships with its stakeholders. Businesses need to recognise the link between improvements in nonfinancial areas and in cash flow or the share price. Such improvements can occur after a time-lag which highlights the importance of relevant non-financial measures as they may act as a lead indicator of future performance.

Non-financial disclosures should support and enhance the information in the financial statements; these may include trend data that can help investors to assess the company's strategy and prospects.

The United Nations' Principles for Responsible Investment (UNPRI) encompass a significant subset of the terms covered by non-financial business reporting. In this regard, the UNPRI has adopted the term, Environmental, Social and Governance (ESG) which covers factors that investors, who wish to be seen as 'Responsible Investors', should take into account and equally, ESG disclosures expected of companies.

'Corporate Social Responsibility' or simply 'Corporate Responsibility' are widely used terms encouraging positive corporate social and environmental practices and, *inter-alia*, their disclosure as part of non-financial business reporting. Some companies have responded to these various demands for additional disclosure by producing "Sustainability Reports" either as part of their annual reports to shareholders or as stand alone reports. In recent years, many companies have embraced various forms of non-financial business reporting, notably in terms of their environmental and social impacts.

CONCLUSION

It has been seen that non financial disclosure is a relevant fact of running a successful business, especially in the context of a global business. The increased thrust on this aspect is a result of both push as well as pull factors, while companies are proactively beginning to respond to the needs of non financial disclosure –the push factor is also due to external regulations, international bodies and various special interest groups that are closely monitoring these companies.

Businesses are increasingly reverting to the basic value systems- rooted in their age old cultures. Value creation is being looked at beyond maximizing return on income or maximizing shareholders wealth but as a way of meeting all stakeholders need and thereby emphasizing on building strong non financial disclosures in their organizations.

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BACKGROUNDER

Sub - Theme 4

Lead the Market under Competition Regime

Break out Session :

1. *Mergers under New Competition Regime*
2. *Regulatory Reforms in Tax Governance*

MERGERS UNDER NEW COMPETITION REGIME

DR S K DIXIT*

Neelie Kores, European Commissioner for Competition Policy spoke in a speech on June 5, 2007, of a 'tsunami' of mergers which she welcomed since it involved the cross-border restructuring of markets in many sectors from energy to banking and from air transport to telecommunications. The corporate world has witnessed frequent bouts of 'merger mania'. For example there was a very high degree of merger activity in the second half of the 1980s, and again in the mid-1990s. From 1998 to 2001 there was a period of frenetic merger activity, although this then declined markedly as the global economy slowed. Another upswing commenced in 2005 and continued through to 2007, not least as private equity firms became involved in ever-larger acquisitions of well-established firms. The European Commission's Table of Statistics, shows clearly the peaks and troughs of merger notifications under the EC Merger Regulations from 335 in 2001, to just 211 in 2003, and up to 402 in 2007.

A notable feature of mergers in recent years has been their increasing complexity, size and geographical reach. Very large mergers have taken place in many sectors as companies sought to restructure and consolidate their place in an increasingly global market. For example, in pharmaceuticals industry Pfizer and Warner-Lambert merged to become the largest pharmaceutical company in the world. Major mergers have taken place in the car industry, for example between Daimler-Benz and Chrysler, Ford and Volvo, Renault and Nissan, and between General Motors and Saab. In the oil industry Exxon merged with Mobil to become the largest oil company in the world, and BP Amoco merged with Arco. Many other industries have also seen a high degree of merger activity.

WHY DO COMPANIES MERGE ?

There are many reasons for companies to merge, most of which are beneficial to, or at least not harmful to, the economy. The reasons may be summarized as under :

(i) Economies of scale

An obvious explanation for some mergers is the achievement of economies of scale. A company will produce goods at the lowest marginal cost where it is able to operate at the minimum efficient scale. If it operates on a smaller scale than this, marginal cost will increase and there will be a consequent loss of allocative efficiency. Economies of scale may be product-specific, where they enable a product to be produced more cheaply; plant-specific, where they mean that the overall use of a multi-product plant is made more rational; or firm-specific, where they result in lower overall costs.

The globalisation of markets, reduction in tariff and other trade barriers and astonishingly rapid technological advancements in recent years have altered the nature and structure of markets. This has consequently provided the companies the opportunities to grow into larger geographical

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markets. It may be that a company can achieve economies of scale by internal growth; equally, however, it may be that this can most easily be achieved by external growth that is by merging with other company.

In addition to economies of scale, a merger may lead to efficiencies in other ways also. It may be cheaper to takeover a distributor than to set up a distribution network on a contractual basis, backward integration may guarantee supplies to a company concerned about the availability of raw materials. A merger might also mean that a company will have improved access to loan and equity capital than it had when operating alone. A merger may result in a company that is better able to carry out research and development and with access to a greater pool of industrial technology. A merger is quite often motivated by a desire to acquire the patents and know-how of a particular firm.

(ii) Market for Corporate Control

The threat of a successful takeover acts as an important influence upon the existing management to ensure that it functions as efficiently as possible. Where shareholders are satisfied with the current management's performance they will not sell their shares to another bidder, unless it is overbidding. If shareholders are dissatisfied, they may prefer to sell at the price offered and to reinvest the proceeds elsewhere resulting in the old management replaced by the bidder. According to this argument the 'market for corporate control' is a crucial element in the promotion of economic efficiency.

(iii) Exiting an industry

Mergers present companies an opportunity of exiting an industry. In a free market it is important to encourage entrepreneurs to invest their money and skills in setting up new businesses and entering new markets. Just as it is desirable to prevent the erection of barriers to entry and expansion that prevent new firms from competing on the market, so too it is necessary to avoid barriers to exit that make it difficult to leave the market. The incentive to set up a company, invest risk capital and develop new products may be diminished if it is not possible to sell the enterprise in question as a valuable going concern. It is quite common, for companies to acquire small undertakings which possess useful know-how or intellectual property rights. The freedom to sell may be an important element in the reward for the risks taken by the inventor of technology. Infact, strict approach to mergers would have an undesirable effect if it makes the exit unduly difficult.

COMPETITION ASPECTS OF MERGER

A true merger involves two separate undertakings merging entirely into a new entity. The merger of Ciba-Geigy and Sandoz in 1996 to form the major pharmaceutical and chemical company Novartis; creation of GlaxoSmithKline as a result of the merger of Glaxo Wellcome and SmithKline Beecham in 2000 are two examples of high profile merger. However, the expression 'merger' used for the purpose of competition includes a far broader range of corporate transactions than full mergers of this kind.

Illustration : Where A acquires all or a majority of the shares in B, this would be described as a merger if it results in A being able to control the affairs of B. Even the acquisition of a minority shareholding may be sufficient, in particular circumstances, to qualify as a merger. Under EC Merger Regulations the question would be whether A will acquire 'the possibility of exercising decisive influence' over B, while under UK Enterprise Act the question would be as to whether A would at least have 'material influence' over B.

The acquisition of assets, for example, a well-known brand name can amount to a merger. Two or more undertakings which merge part of their businesses into a newly-established joint venture company, may be found to be parties to a merger. In each case, the essential question is whether previously independent businesses have come or will come under common control with the consequence that, in the future, the market will function less competitively than it did prior to the merger.

The term 'merger' has been used in this article to encompass all these phenomena unless the context requires a different usage except in the context of EC system, where the EC Merger Regulations used the word concentration and in India it has been used as combination.

Competition law the world over focus on the possibility that a merger will lead the market to be less competitive in the future than it is currently. The main concern of competition authorities when assessing a merger is whether it will have adverse horizontal effects. There may also be concerns about vertical and conglomerate effects, but these concerns are much rarer. It may also be possible that the same case can give rise to horizontal, vertical and conglomerate concerns. The effects of merger are summarised as under :

(i) Horizontal Effects of Merger : Horizontal effects occur where a merger takes place between actual or potential competitors in the same product and geographic markets and at the same level of the production or distribution cycle. As a general proposition the horizontal effects of merger present a much greater danger to competition than vertical (or conglomerate), in the same way that horizontal agreements are treated more strictly than vertical agreements. Horizontal mergers may be scrutinised both for their 'unilateral' or 'non-coordinated' effects and for their 'coordinated' effects.

(ii) Vertical Effects of Merger : Vertical effects may be experienced where a merger occurs between firms that operate at different, but complementary, levels of the market for the same final product. To illustrate A might produce a raw material (an 'upstream product) for a product produced by B (a 'downstream' product'). Often such mergers enhance, or be neutral, in terms of economic efficiency, but there is a possibility that vertical integration may have a harmful effect on competition, either because it gives rise to a risk of the market becoming foreclosed to third parties or because it could lead to collusion between the merged entity and third parties.

(iii) Conglomerate effects of Merger : There have been a few occasions on which competition authorities have had concerns about mergers not on the basis of horizontal or vertical effects, but because of possible conglomerate effects.

Illustration : The merger between A and B who are neither horizontal competitors, nor functionally related vertically, might enable the merged entity AB to use its market power in two different but related, or even unrelated, markets to foreclose competitors.

Whether conglomerate mergers should be controlled at all is a matter of controversy. US law abandoned any interest in the conglomerate effects of mergers. However, the European Commission has expressed concern about the 'portfolio' or 'range' or 'conglomerate' effects of mergers on various occasions.

MERGER CONTROL UNDER COMPETITION LAW

What is the purpose of merger control under the Competition Law and Policy. There may be various reasons for Governments, the companies, shareholders, and the individuals to object to mergers. Some of them are summarised as under :

(i) A Government may object to a merger for a number of reasons. It might disapprove of a foreign company takingover a domestic company, or a merger that does not fit in its industrial policy, or on the ground of job loss resulting from closing down of a production facility due to merger.

(ii) A company might object to being the target of a hostile bid, or to a merger between two rivals that might give them a competitive edge.

(iii) Shareholders might be concerned that the merger will have an adverse effect on the value or effectiveness of their shares.

These being appreciable concerns from the point of view of government, shareholders or the companies etc., the same is not true from the competition law perspective. Competition policy and competition authorities are concerned with maintaining the process of competition in the market place, not as an end in itself, but as a way of maximising consumer welfare. The merger control under some jurisdictions allow broader 'public interest' criteria to be taken into account in the overall assessment of a merger. However, in most jurisdictions competition authorities are concerned with just one issue, i.e. the assessment of the competitive effects of mergers. In India, mergers under the Competition Act, 2002 would be assessed on the basis of appreciable effect on competition.

MERGER CONTROL IN SELECT JURISDICTIONS

Following paragraphs discuss in brief the regulatory framework for merger control under selected jurisdictions.

I. Merger Control in European Commission (EC)

The European Commission first proposed that a regulation for the control of mergers should be adopted as early as 1973. However, it was not until 21 December 1989 that the Council of Ministers finally adopted Regulation 4064/1989; which came into force on 21 September 1990. Regulation 4064/1989 was amended quite significantly by Regulation 1310/97, and was repealed and replaced by the present EC Merger Regulation (ECMR) in 2004.

Hence, the EC rules on the merger control (concentrations) contained in the EC Merger Regulation, (ECMR). Regulation 139/2004 has been applicable since May 1, 2009. Earlier, Regulation 4064/89 had been in effect since 21 September 1990.

Regulation 139/2004 amended the rules of merger control in a number of respects, in particular by making the allocation of jurisdiction between Member States and the European Commission more flexible and by amending the substantive test for the analysis of mergers. Under the present EC system of merger control, Mergers having community dimension must be pre-notified to the Commission. The Community dimension in a merger is determined by reference to the turnover of the undertakings concerned in a transaction. Where a merger has a Community dimension the Commission has sole jurisdiction known as the principle of 'one-stop merger control'. However in some circumstances the Commission may allow jurisdiction (wholly or in part) over a merger having a Community dimension to a Member State; while in certain other situations it is obliged to do so.

There are also circumstances in which Member States may transfer jurisdiction to the Commission over mergers that do not have a Community dimension. Most cases are completed within 25 working days of the notification, known as a Phase I investigation. In approximately 5 per cent of cases the Commission finds that, at the end of Phase I investigation, it has serious doubts as to the compatibility of the merger with the common market and so it proceeds to an in-depth Phase II investigation which may take an additional 90 working days, to be extended for up to an additional 35 working days.

Salient Features of EC Merger Regulation

Article 3 : Meaning of a Concentration : ECMR applies to mergers (concentrations), as defined under Article 3 and further explained in the case law of the Community Courts and Commission's Consolidated Jurisdictional Notice.

Articles 1 and 5 : Concentrations having a Community Dimension. The ECMR applies to concentrations that have a 'Community dimension'. The term community dimension has been defined under Article

1, and further explained in the Jurisdictional Notice. The community dimension is determined with reference to the turnover of the 'undertakings concerned', including their affiliated undertakings as set out in Article 5.

One-stop merger control : As a general proposition concentrations that have a Community dimension are investigated only by the Commission and not by the Member States. This is called the principle of 'one-stop merger control'.

Referral of concentrations having a Community dimension to the competent authorities of the Member States. In certain cases Article 4(4) and Article 9 provide a mechanism whereby concentrations that have a Community dimension can be reviewed by the competent authorities of the Member States, either because the undertakings concerned or a Member State make a request to that effect. The Commission's Notice on Case Referral in respect of concentrations provides important guidance on the subject

Referral of concentrations not having a Community dimension by Member States to the Commission. In certain cases Article 4(5) and Article 22 provide a mechanism whereby concentrations that do not have a Community dimension can be investigated by the Commission, either because the undertakings concerned or a Member State makes a request to that effect. Here also the Case Referral Notice provides important guidance.

Legitimate Interest Clause : Member States are not allowed to apply their domestic competition law to concentrations that have a Community dimension except in the circumstances in which Article 4(4) or Article 9 are attracted. However, in terms of Article 21(4) of the ECMR Member States may investigate a concentration having a Community dimension where it threatens to harm some 'legitimate interest' of the State other than the maintenance of competition.

Defence : Member States retain jurisdiction to examine the national security aspects of mergers under Article 296 of the EC Treaty.

Implementing Regulation and Guidelines

In addition to the EC Merger Regulations, there are a number of Implementing Regulation, Commission Notices and Guidelines, including the Guidelines on Best Practices. The Commission is bound by its notices in the area of the supervision of mergers, provided they do not depart from the rules in the Treaty or from the EC Merger Regulations.

Commission Regulation 802/2004 contains rules on notifications to the Commission, time limits, the right to be heard and hearings, access to the file and the treatment of confidential information and remedies. The Commission has published a number of Notices and Guidelines on procedural and substantive matters. The Commission has also published Guidelines setting out 'Best Practices' on two aspects of merger controls namely DG Competition Best Practices on the conduct of EC merger control proceedings; and the Commission's model texts for divestiture commitments and the trustee mandate.

The Commission's Decisions

The website of Director General for Competition is an important source of material about the operation of the EC Merger Regulations, as well as the legislation and guidance. The website contains information about both completed cases and current investigations. The website also contains interesting statistical information about the EC Merger Regulation in practice and useful studies and reports on matters such as unilateral effects, tacit collusion and the impact of vertical and conglomerate mergers on competition.

The Commission's decisions can be accessed in various ways. A press release summarising the Commission's finding in cases other than those for which the simplified procedure is available, is published in English, French, German and in the language of the notification. The non-confidential version of the full decisions are published on the Commission's website.

II Merger Control in United Kingdom (UK)

The Law relating to control of mergers in United Kingdom is contained in Part 3 of the Enterprise Act 2002, which came into force on 20 June 2003. Merger control in UK first introduced by the Monopolies and Mergers Act 1965, was replaced by the Fair Trading Act 1973. A Consultative Document was published in August 1991 proposing a number of changes to the system of merger control in the UK. The main proposals were however, included in the White Paper on Productivity and Enterprise - A World Class Competition Regime of July 2001.

A salient feature of the reform was that responsibility for making decisions in merger cases should be given to the Office of Fair Trading ('the OFT') and the Competition Commission ('the CC'), and the Secretary of State should become involved only in cases which raise exceptional public interest issues; and the decisions to be adopted by the OFT and CC be made against a **'substantial lessening of competition'** test, rather than the public interest test set out in the Fair Trading Act. In India the mergers would be determined on the basis of appreciable adverse effect on Competition.

These changes were put into effect by Part 3 of the Enterprise Act 2002. However there are some specific rules for 'public interest cases', for 'other special cases' and for certain mergers between water companies. The special regime for newspaper mergers that was contained in the Fair Trading Act was repealed by the Communications Act 2003.

It may be noted and as earlier mentioned a merger that has a 'Community dimension' under the EC Merger Regulation (the 'ECMR') cannot be investigated under domestic law, although exceptions to this are to be found in Article 4(4), Article 9 and Article 21(4) of the Regulation.

Salient Features of UK Merger Control

Part 3 of the Enterprise Act 2002 dealing with merger control in United Kingdom consists of five chapters.

(i) Chapter 1 deals both with jurisdictional matters, such as the meaning of 'relevant merger situations', and also with the substantive assessment of mergers under the substantial lessening of competition test.

(ii) Chapter 2 contains provisions relating to 'public interest' cases

(iii) Chapter 3 addresses 'other special cases'.

(iv) Chapter 4 contains rules on enforcement, which set out the various undertakings that can be accepted by the Office of Fair Trading (OFT) and the Competition Commission (CC) in the course of merger investigations and the orders that they may make, as well as certain automatic restrictions on the integration of firms during the currency of an investigation.

(v) Chapter 5 deals with a number of supplementary matters, such as merger notices, investigatory powers, review by the Competition Appeal Tribunal and the payment of fees.

Section 3 provides for procedures of the OFT in determining whether a merger should be referred to the CC and in deciding to accept undertakings in lieu of a reference. Section 4 provides for procedures of the CC and section 5 discusses the manner in which the OFT and the CC apply the Substantial Lessening of Competition Test in practice. Section 6 explains the enforcement powers under the Act, including the remedies the CC can impose in merger cases. Various supplementary matters dealt with in section 7 and section 8 considers how the merger control provisions have been working in practice since the Enterprise Act come into effect. Section 9 provides a brief account of the provisions on public interest cases and mergers in the water industry.

An important feature of the merger provisions under the Enterprise Act is that the Secretary of State is not involved at all, unless there is a point of exceptional public interest. Sectoral regulators do not have concurrent powers in relation to mergers in the way that they do under the Competition Act 1998 and the market investigation provisions in the Enterprise Act. However they may be asked to provide input into the deliberations of the OFT and the CC in appropriate cases.

Guidelines and General Advice

In addition to Part 3 of the Enterprise Act various guidelines, rules and other publications seek to explain the operation of the UK system of merger control. Section 106 of the Act requires the OFT and the CC to prepare and publish general advice and information about the making of merger references and, in the case of the CC, about the way in which relevant customer benefits may affect the taking of enforcement action. Section 107 of the Act imposes additional publicity requirements on the OFT, the CC and the Secretary of State.

III. Merger Control in India

Substantive provisions relating to regulation of combinations are contained in section 5 and section 6 of the Competition Act, 2002. Combination for the purposes of the Act has been defined under section 5, whereas regulation of combinations is provided under section 6. The violation of section 6 pertaining to regulation of combinations occurs when a combination as defined under section 5 has the effect of causing appreciable adverse effect on competition in the relevant market in India.

The combination in terms of section 5 denotes that the acquisition of one or more enterprises by one or more persons or merger or amalgamation of enterprises shall be a combination of such enterprises and persons or enterprises, which are above the certain prescribed size in terms of assets or turnover. Section 5 provides certain size-related thresholds and only an acquisition, acquiring of control, merger, or amalgamation above these thresholds is covered by the definition of combination.

Thus, combinations below the specified thresholds are beyond the jurisdiction of the Competition Commission insofar as regulation of combinations is concerned. Section 20(3) provides that these thresholds are subject to revision bi-annually by the Central Government so as to account *inter alia* for inflation and exchange rate fluctuations.

Salient Features of Merger Control in India

Determination of Turnover : The definition of the term 'turnover', *inter-alia*, is relevant and significant in determining whether the combination of combining entities exceeds the threshold limit of the turnover specified in Section 5 of the Act. In terms of Section 2 (y), the turnover includes value of sale of goods or services.

Computation of Value of Assets : Value of the assets for the purposes of regulation of combinations shall be determined on the basis of the book value of assets as shown, in the audited books of account of the enterprise, in the financial year immediately preceding the financial year in which the date of proposed merger falls, after deducting there from any depreciation.

The value of the assets shall also include the brand value, value of goodwill, or value of copyright, patent, permitted use, collective mark, registered proprietor, registered trade mark, registered user, geographical indications, design or layout design or similar other commercial rights, referred to in Section 3(5) of the Competition Act, 2002.

Determination of Appreciable Adverse Effect on Competition : Section 6 of the Act provides that no person or enterprise shall enter into a combination which causes or is likely to cause an appreciable adverse effect on competition within the relevant market in India and if such a combination is formed, it shall be void.

While inquiring as to whether a combination causes or is likely to cause an appreciable adverse effect on competition, Competition Commission shall in terms of section 20(4) have due regard to all or any of the following factors, namely,

(a) actual and potential level of competition through imports in the market;

(b) extent of barriers to entry into the market;

(c) level of combination in the market;

(d) degree of countervailing power in the market;

(e) likelihood that the combination would result in the parties to the combination being able to significantly and sustainably increase prices or profit margins;

(f) extent of effective competition likely to sustain in a market;

(g) extent to which substitutes are available or are likely to be available in the market;

(h) market share, in the relevant market, of the persons or enterprise in a combination, individually and as a combination;

(i) likelihood that the combination would result in the removal of a vigorous and effective competitor or competitors in the market;

(j) nature and extent of vertical integration in the market;

(k) possibility of a failing business;

(l) nature and extent of innovation;

(m) relative advantage, by way of the contribution to the economic development, by any combination having or likely to have appreciable adverse effect on competition;

(n) whether the benefits of the combination outweigh the adverse impact of the combination, if any.

Compulsory Notification of Combinations : In terms of section 6(2), any person or enterprise, who or which proposes to enter into any combination, is required to give a notice of forming a combination to the Commission , in the prescribed form, together with the fee prescribed under regulations within thirty days. However, such a combination has to be intimated only if it is above threshold limits, as earlier discussed.

Further, if the combinations is between persons or enterprises having operations in India or outside India, such compulsory intimation will be necessary only if the operations of the combined entity has assets of atleast Rs. 500 crores or turnover of atleast Rs. 1500 crores in India.

Such intimation/notice should be submitted within thirty days of –

(a) approval of the proposal relating to merger or amalgamation, referred to in Section 5(c), by the board of directors of the enterprise concerned with such merger or amalgamation, as the case may be;

(b) execution of any agreement or other document for acquisition referred to in Section 5(a) or acquiring of control referred to in Section 5(b) or once the intimation is received by the commission, it will do all that is necessary and give its ruling within maximum period of 210 days.

In terms of section 6(2A), combination shall not come into effect until 210 days have passed from the day on which notice has been given to the Commission about proposed combination or the Commission has passed orders on such combinations under section 31.

Non applicability of Section 6 : In terms of Section 6(4), provisions relating to regulation of combinations shall not apply to share subscription or financing facility or any acquisition, by a public financial institution, foreign institutional investor, bank or venture capital fund, pursuant to any covenant of a loan agreement or investment agreement.

However, in terms of section 6(5), the public financial institution, foreign institutional investors, bank or venture capital fund, are required to file with the Competition Commission in prescribed form, details of the control, the circumstances for exercise of such control and the consequences of default arising out of loan agreement or investment agreement, within seven days from the date of such acquisition or entering into such agreement, as the case may be.

Inquiry into Combination : In terms of section 20(1) of the Act, the Commission may, upon its own knowledge or information relating to –

(i) acquisition referred to in clause (a) of section 5; or

(ii) acquisition of control referred to in clause (b) of section 5; or

(iii) merger or amalgamation referred to in clause (c) of section 5,

inquire into whether such a combination has caused or is likely to cause an appreciable adverse effect on competition in India. However, the Commission shall not initiate inquiry under section 20(1) after the expiry of one year from the date on which such combination has taken effect.

Combination Deemed to be Approved : A deeming provision has been introduced by Section 31(11), providing that if the Commission does not, on expiry of the period of two hundred and ten days from the date of notice given to Commission under section 6 (2) pass an order or issue any direction in accordance with the provisions of Section 31 (1) or Section 31 (2) or Section 31 (7), the combination shall be deemed to have been approved by the Commission.

Calculation of 210 days : In reckoning the period of two hundred and ten days, the period of thirty days specified in Section 31 (6) and further period of thirty working days specified in Section 31(8) if granted by Commission, shall be excluded. [Explanation to Section 31(11)].

Where extension of time is granted on the request of parties the period of ninety working days shall be reckoned after the deducting the extended time granted at the request of the parties from time actually taken. [Section 31(12)]

Combination to be Dealt by Concerned Authorities : Where the Commission has ordered that a combination is void, as it has an appreciable adverse effect on the competition, the acquisition or acquiring of control or merger or amalgamation referred to in section 5, shall be dealt with by other concerned authorities under any other law for the time being in force, as if such acquisition or acquiring of control or merger or amalgamation had not taken place and the parties to the combination shall be dealt with accordingly. [Section 31(3)]

ROLE OF COMPANY SECRTARIES

Competition Authorities and companies the worldover avail services of professionals to guide and advise them on various aspects of competition law. Accordingly, the Company Secretaries would be called upon to provide the services under various provisions of the Competition Act, 2002.

The Competition Act, 2002 authorises Company Secretaries in practice to appear before Competition Commission of India and Competition Appellate Tribunal. Besides, there are also a number of concepts, terms such as value of assets, turnover, determination of market, relevant market, geographic market which would require active professional involvement and advice. Further, Competition Act, 2002 provides a number of factors to be considered by the Competition Commission of India in determining appreciable adverse effect on competition. Thus, in view of Core Competence of Company Secretaries in the area of company, corporate, economic laws, the Competition Act, 2002 has opened new opportunities for them to render valuable services to Competition authorities and the corporate sector, in India.

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GOODS & SERVICE TAX — GEAR-UP FOR TRANSITION

CS M K GUPTA* & CA APARNA CHAUHAN**

A unified tax system is prerequisite for a nationwide common market which permits free and unimpeded movement of goods and services across the country, thus encouraging efficient regional specialisation. Such harmonisation will significantly reduces the vertical imbalance between Centre and States by enhancing the tax base of the States. Better and imperative linkages of the transactions will plug the leakages and the whole system of taxation will be characterized by transparency and better compliances. Industry will get the much sought relief from the compliances to a large number of tax statutes and the fear of failure to meet the deadlines of various returns, assessments, tax deposits and so on. The reduced cost of compliances will contribute to the bottom line of trade and industry.

The confidence of Hon'ble Finance Minister of West Bengal Shri Asim Dasgupta is high that country will have a new indirect tax regime on 1st April, 2010 in the form of 'Goods and Service Tax' (GST). And why not? His efforts and perseverance have seen the successful implementation of VAT in 2005. Now, as the Chairman of the empowered group of state finance ministers on GST, he is making all round efforts to ensure that the GST becomes a reality on 1st April, 2010. We, the Company Secretaries, have to start planning for smooth transition of our respective organizations.

The purpose of GST is to have one uniform indirect tax regime and to do away with multiple taxes like CENVAT, Central sales tax, Value Added Tax (VAT), services tax and a number of other taxes being levied and collected by the State governments under different nomenclatures.

The GST is a comprehensive value added tax on goods and services. Through a tax credit mechanism, GST is levied and collected on value addition at each stage of the supply chain. GST paid on the procurement of goods and services can be set off against that GST payable on the supply of goods or services. The end consumer in the supply chain has to bear the tax. Therefore, GST is like a last-point retail tax.

It is seen as a genuine value addition tax neutralizing the cascading effect of all the indirect taxes, Central or State, therefore removing the ill-effects of the existing indirect tax regime prevailing in the country. For instance, when a shoe company produces a pair of shoes, the Central Government charges an excise duty as the final product leaves the factory. At the retail level, the state where the outlet is located, charges VAT without giving credit of the excise duty levied earlier i.e. the state VAT is levied on top of the Central Excise Duty. In the GST system, both Central and State taxes would be collected at the point of sale. Both components (the Central and state GST) may be charged on the manufacturing cost. Since there will not be any cascading effect therefore the prices to the ultimate consumer are expected to come down.

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Almost 140 countries have implemented GST and most of these countries have a unified GST system. Brazil and Canada follow a dual system where GST is levied by both the Union and State governments. Therefore, the adoption of GST regime will be a very important step towards adoption of best international practices in the area of taxation. The elimination of distortions and easy compliances will surely be a positive and further strengthen the consumer friendly environment.

STRUCTURE OF GST

Considering the federal structure of governance in India and the sovereign taxation powers of the Central and State Government, dual GST system has been proposed, meaning thereby, there will be separate GST for Centre (CGST) and States (SGST). Accordingly, the Central Excise duty, Additional Excise Duty, Countervailing Custom Duty, Special Additional Duty of Customs, Service tax and Surcharge/ Cess will come under the ambit of CGST similarily, State Value Added Tax, Entertainment Tax, Luxury Tax, Lottery Tax, Entry Tax (other than for local government), state surcharges etc. will fall under the scope of SGST. It will results into merger of number of taxes at the central and state level, cut in effective tax rate for many goods, removal of the current cascading effect of taxes, reduction in transaction costs for taxpayers through simplified tax compliance, and increased tax collections due to wider tax base and better compliances.

Imports will be subject to GST. Exports however will be zero rated, and thus exporters of goods and services would not be required to pay GST on their exports. Hence, the GST paid by them on the imports will be refunded.

RATES OF GST

States and Union territories have agreed on three rates of taxes on transactions of goods. There will be lower rate for the items of mass consumption (i.e. essential commodities), a standard rate for other goods and a nominal rate of 1% on precious metals along with a list of goods which will be exempted from GST. The classification of GST rate is similar to one in State level VAT. Further alcohol, tobacco, petroleum products are likely to be out of the GST regime. Some small and medium enterprises would also stay outside the ambit of GST.

TRADE AND INDUSTRY — CHALLENGES AHEAD

April 1, 2010 being the scheduled date for implementation of GST, The time constraint is certainly a biggest challenge. Another challenge is bringing about an integration of all taxes levied on goods and services. The Centre levies duties of excise on manufactures and import/countervailing duties on international imports apart from levying a tax on services under various tax and the residuary entries in the Union List. The States levy VAT on goods sold or entering in the state, entertainment tax, luxury tax etc under various entries of the State list. Even if all Union-level levies are integrated into a single levy and all State level levies merged in a single State level levy, there would still be two levies. The most important task before the government is to draft an all comprehensive legislation and to effect the required constitutional changes after addressing and accommodating the views and concerns of all the stakeholders.

The States have agreed on the dual GST rate structure however the actual standard rate and special rate are yet to be agreed upon. The exemption list may not be easy to agree upon by all the States due to their local and specific requirements. But any differences on the exempted items would lead to distortions in the rates across the states and ultimately in the movement of the goods. Since it is unlikely that the petroleum products, tobacco and alcohol will be brought within the ambit of GST, this will lead to a situation of co-existence of GST and VAT in respect of such goods. Classification of goods attracting special rates across the States is also an area of concern because the differences would again lead to rate and trade distortions. Further, major challenge before the implementation of GST is the taxation of inter-state supply of services.

Further, other procedural concerns and challenges involved in changing over to the proposed GST implementation may be summarized as under:-

- Treatment of carried forward tax credit under CENVAT and State VAT;
- Transitional Provisions;
- Treatment to existing exemptions and benefits – location based and product based;
- Standardisation of systems and procedures at national level among all States;
- Issues related to compliance requirements including:
  - Registration requirements;
  - Payment of tax and filing of returns;
  - Records to be maintained;
  - Accounting and IT system; and
  - CENVAT Records;
- Eligibility and utilisation of tax credit in case of inputs, input services and capital goods;
- Refund procedures;
- Taxability in case of unregistered dealer; and
- GST where the service provider or the recipient is in the State of Jammu and Kashmir.

CONCLUSION

GST like any other new system would have its own intricacies embedded at the initial stages. Lower incidence of tax, reduced prices, a move towards the global concept, reducing cost of tax compliance, better revenue collection, an efficient and harmonised consumption tax system are all hallmark of the proposed system, however it would be a challenge before the government to address various legal, technological, procedural issues and concerns. The role of professionals like Company Secretaries is to support the government by providing constructive inputs and creating a positive environment so that the government achieves success in its endeavour.

ENTERPRISES NEED TO KNOW

1 April, 2010 being the date of implementation of GST, it is imperative for professionals to gear up for the transition and take all necessary steps, to avoid tax loss. To ensure smooth transition, issues like record-keeping and documentation, capability of computer systems to capture information essential under GST and understanding of GST need to be addressed without any delay. It would be imperative for enterprises to re-engineer the sourcing, distribution, imports and supply chain strategies in a manner most beneficial and competitive for their businesses.

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BACKGROUNDER

JOURNEY OF TAX REFORMS — PAST, PRESENT AND FUTURE

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Tax systems in India have undergone significant changes since independence. Inevitably tax policy in the country has responded to changing development strategy over the years. In the initial years tax policy was guided by a large number of demands placed on the government. These demands can be summarized as the need to increase the level of savings and investment in the economy and hence the need to stimulate growth and ensure a fair distribution of incomes arose. That in turn meant an effort to raise taxes from those with an ability to pay, with little regard for the efficiency implications of the chosen instruments for the purpose.

The wave of tax reforms caught the speed in the mid-1980s and accelerated in the 1990s. Transition from a planned economy to a market economy necessitated wide ranging tax reforms. Another driving force was the internationalization of economic activities. On the one hand, globalization entailed significant reduction in tariffs, and on the other, it emphasized the need to minimize the compliance costs of the tax system. Lately, the tax reforms were broadly in conformity with international trends and best practices.

CONSTITUTIONAL BASE

Constitutional distribution of powers to levy tax has stood the test of the time in terms of clarity, permanency and mutual harmony. The Union Government has the sovereign power to levy income tax (other than agricultural income), custom duty, excise duty (except on alcoholic liquors and narcotics meant for human consumption), corporation tax and service tax and the State Governments have been assigned power to levy tax on sale and purchase, stamp duty, professional tax, octroi etc. Unambiguous constitutional distribution has restricted the scope of tax reforms to the legislative and administrative arena.

INITIAL TAX REFORMS

Tax Enquiry Commission, 1953 was the first systematic initiative to design a tax system in independent India with the primary objectives of improving the level of savings and investment, making the resource available to the public sector for developing an industrial base and equal distribution of national wealth. Making resources available for financing the five year plans was the underlining objective of the tax reforms. The reforms covered both the centre and states within its scope.

Subsequently, several tax reforms were brought out which have been by and large partial. The Kaldor Committee, 1956 recommended expenditure tax as a measure to curb consumption but it was withdrawn in 1957-58 itself as it did not contribute much to the exchequer. This was an era when the tax rates were very high hooked to too many slabs. In 1973-74, the personal income tax rates were

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between 10 to 85 % divided in eleven slabs plus 15% surcharge meaning thereby that government would take away 97.75 rupee out of every 100 rupee earned by an assessee assuming he is in the bracket of highest tax rate. Enforcement was inefficient and tax evasion was too high which used to remain beyond the timely detection. The obvious outcome of all this was generation of black money which remained not only non-available for the development but became source of economic inequalities and imbalances. Therefore, the Direct Taxes Enquiry Committee, 1971 recommended significant reduction in marginal tax rates. The process of de-escalation of income tax rates was set in motion which brought the highest rate to 50 percent in 1985-86 divided in four tax slabs.

On indirect tax side, a major procedural simplification was introduced in 1968 in the excise laws whereby the physical control system gave way to the Self Removal Procedure repositioning trust on the taxpayers and a significant step was taken towards self-regulation. The Indirect Taxes Enquiry Committee, 1977 recommended the simplification of the indirect taxes.

A land mark reform in the indirect tax system was introduced when Modified Value Added Tax (MODVAT) was introduced in the excise laws in 1986 to avoid the cascading effect of excise duty paid on inputs.

Imports were very restricted in the initial years after independence. Restrictions were both in terms of tariff and non-tariff barriers. By the middle of 1980s, the tariff rates were extremely high and the structure complex. In the year 1984-85 the Government presented its Long Term Fiscal Policy (LTFP) in the Parliament which focused on reduction of tariffs, fewer rates and greater uniformity and reducing and eventually eliminating quantitative restrictions on imports. However, contrary to the LTFP recommendations, the tariffs were raised for revenue reasons, and the weighted average rate increased from 38 percent in 1980–81 to 87 percent in 1989–90.

Post 1991 – Tax reforms as an integral part of major economic reforms

In 1991, Indian economy saw an unprecedented macroeconomic crisis in the form of unsustainably high fiscal deficit and precarious position of foreign exchange reserves. As a reaction to the crisis, India embarked upon major economic reforms towards liberalization and globalization. Tax reforms were considered to be an integral part of the reform process. Therefore, the government of India appointed a Tax Reform Committee headed by Dr. Raja Chelliah, the noted economist. The main recommendations of the Committee comprised:

— reduction of the tax rates of the major taxes namely individual and corporate income taxes, excise duty, customs duty ;

— enlargement of the tax base of all taxes by reducing exemptions and concessions;

— transformation of the taxes on domestic production into a value added tax;

— the simplification of laws and procedures to make the administration and enforcement of the tax system more effective ;

— Computerisation of tax returns and modernisation of administrative and enforcement machinery.

DIRECT TAX REFORMS

Taking cue from the recommendations of the Tax Reform Committee, 1991 the tax rates were simplified to have three slabs beginning with a rate of 20 per cent, a middle rate of 30 per cent and the maximum rate of 40 per cent in 1992-93. Further reduction came in 1997-98 when, the three slab rates were brought down further to 10-20-30 per cent. Personal income tax rates have remained stable since 1997–98, at 10, 20, and 30 percent, with some changes in the associated tax brackets.

A surcharge of 5 percent on the income tax was imposed in 2002–03 in the wake of the Kargil war and was discontinued the following year. It was replaced, however, with a separate 10 percent surcharge imposed on all taxpayers with taxable incomes above Rs. 850,000; the level was raised to Rs. 1 million in the 2005–06 budget. Further, all taxes are topped up by a 2 percent education cess and 1 percent secondary and higher education cess.

The budget for 2005–06 raised the exemption limit to Rs. 100,000, abolished the standard deduction, and made marginal changes in the tax brackets. The exemption limit was increased to Rs. 135,000 for women and to Rs. 185,000 for senior citizens. Savings in a variety of instruments including pension funds up to Rs. 100,000 were made deductible from taxable income.

In the case of corporate taxation too, the basic rate was brought down to 50 per cent, and rates applicable to different categories of closely held companies were unified at 55 per cent. But in the year 93-94, both closely held and widely held companies taxed at par and the tax rate come down to 40% for all domestic corporates. In the year 97-98, the burden of tax on dividend on individuals was shifted on corporates which was taxable at the rate of 10% and due to this the corporate income tax rate declined to 35%. The system of taxing of dividends again shifted on shareholders during the period of 2000-01 and 2003-04. However, at last the Dividend Distribution tax came into existence and charged on the corporates. In 2005–06, the corporate income tax rate was reduced to 30 percent on domestic companies. A surcharge of 10 percent (without any conditions regarding installed capacity) is also chargeable. Further, the depreciation rate has been reduced to 15 percent in the case of general plant and machinery, but initial depreciation is set at 20 percent, thereby reducing the overall benefit of lowering corporate income tax rates.

Certain types of tax incentives and concessions were the major area of tax reforms for individuals and corporates provided in the form of investments in infrastructure, financial assets, retirement benefits, development of house by way rebate on loan and interest thereon. Development of backward areas of India was the need of the hour and incentives were provided to the industries to locate their projects in such areas. Thereby many companies planned their activities in such a way that they are able to take the full advantage of such concessions.

The Minimum Alternate tax was introduced in 1983 under section 80VVA with a view to compel highly profitable companies, paying little or no tax due to availment of tax incentives. This section remained in operation from the Assessment Year 1984-85 to 1987-88.

From 1st April 1988, Section 115J was introduced to replace Section 80VVA. By virtue of this section, in case of a company whose total income was less than 30 % of the book profits, the total income to be charged to income tax was deemed to be 30 % of the book profits. Section 115J was in operation from the Assessment Year 1988-89 to 1990-91.

In the year 1991-92, in view of rationalization of tax structure including discontinuance of certain investment incentives, it was felt that there should be no necessity of retention of the concept of a Minimum Alternate Tax, and therefore this section was withdrawn from Assessment Year 1991-92. After a gap of about six years, the Minimum Alternate Tax was re-introduced under section 115JA with effect from Assessment year 1997-98. In the next year, Section 115JAA was introduced to give effect to a tax credit scheme by which the tax paid under MAT was allowed to be carried forward for set off against regular tax payable during the subsequent five year period.

In 2000, the Government had yet another rethink on the concept of MAT, and section 115JB was introduced. The introduction of Section 115JB was a conceptual departure from "deemed total income" to "deemed tax" on book profits. Thereby a company is liable to pay MAT if the tax payable on total income is less than 10% of book profits.

The Income Tax Act has a provision to assess the value of identifiable perquisites provided by companies to their employees and to include the same in the taxable income of the individual. The budget for 2005–06 went a step further and classified a range of other expenses by the company, which provide indirect perquisites to the entire group of employees but are not directly assignable to any single employee. A specified proportion of each of these benefits is to be taxed at a rate of 30 percent through Fringe Benefits Tax (FBT), to be paid by the employer. Benefits covered include entertainment, conferences, employee welfare, sales promotion including publicity, conveyance, tour and travel (including foreign travel expenses), and use of the telephone. The Budget 2009-10 has however withdrawn the FBT.

The most important reform in recent years is in tax administration. Expansion of the scope of tax deduction at source is one of the significant measures taken to reach the "hard to tax" groups. Further, every individual living in a large city and covered under any one of the six conditions (ownership of house, ownership of a car, membership in a club, ownership of credit cards, foreign travel, and a subscriber of a telephone connection) is necessarily required to file a tax return. However, this scheme has now been abolished. The government is also issuing permanent account numbers and strengthening the tax information system.

Strengthening the information system, along with processing and matching the information from various sources on a selective basis is an important initiative that is likely to improve tax compliance.

INDIRECT TAX REFORMS

1. Central Excise Duties

Earlier excise duties were levied on selected goods but over the years, as the revenue requirement increased, the list of commodities subject to duty was expanded. Further for reasons of administrative convenience, the duties were levied on raw material and intermediate goods rather than final consumer goods. In the year 1975–76 the ambit of the duty was extended to all manufactured goods.

There were two ways of levying the commodities either levy a specific duty or ad valorem duty and the later one had 24 different rates varying from 2 to 100 per cent (excluding tobacco and petroleum products which were taxed at higher rates). The Indirect Tax Enquiry Committee recommended for conversion of specific duties into ad valorem, unification of duty rates and introduction of input duty credit to convert the duty into a manufacturing stage value added tax (MANVAT) to curb the cascading effect of tax as levied on inputs, capital goods as well as on final consumer goods. The process of converting specific duties to ad valorem rates was more or less completed by 1993–94 and side by side the coverage of the credit mechanism also evolved over time. It began with selected items, with credit based on a one-to-one correspondence between inputs and outputs. It was only by 1996–97, that it covered a majority of commodities.

The recommendation of Tax Reform Committee brought wide ranging excise duty reforms. In the year 1999-2000, 11 tax rates were merged into three tax rates along with two other rates on luxury items. Further these three rates were merged into a single rate in 2000–01 to be called a central VAT (CenVAT), along with three special additional excises of 8, 16, and 24 percent for a few commodities.

Further, simplification of the duty on the small-scale sector was also brought in. Small businesses could either take an exemption or pay duty at a concessional rate of 60 percent of duty due, with access to the tax credit mechanism. This option, however, was withdrawn from the budget of 2005–06.

2. Customs Duties

The reform of import duties began in 1991–92 when all duties on non-agricultural goods above 150 percent were reduced over the next four years to 50 percent, and then to 40 percent in 1997–98, 30 percent in 2002–03, 25 percent in 2003–04, and finally to 15 percent in 2005–06. The number of major duty rates was reduced from twenty-two in 1990–91 to four in 2003–04. Of course, some items were outside these four rates, but 90 percent of the customs duty was collected from items under the four rates. At the same time, a special additional duty was imposed on goods imported into the country on the rationale that if the commodity was domestically produced and sold interstate, it would have attracted the tax rate of 4 percent. This duty was abolished in January 2004, only to be reintroduced in 2005–06.

3. Service Tax

The total indirect tax structure was skewed against the manufacturing sector. Service sector contributes almost 50 percent of headed GDP but there was no taxation on the services provided by this sector. The Tax Reform Committee headed by Dr. Raja Chelliah recognized the revenue potential of the service sector and recommended imposition of "service tax" on selected services. Although there was no specific authority to tax services, the Central Government using its residuary powers, levied taxes on three services in 1994–95: insurance other than life insurance, stock brokers, and telecommunications. The list was expanded in succeeding years and now includes more than one hundred eight services. The initial 5 percent tax rate was increased to 8 percent in 2003–04 and to 10 percent in 2004–05.

The Expert Group on Taxation of Services recommended extending the tax to all services, providing an input tax credit for both goods and services, and eventually integrating the services tax with the CenVAT. With these reforms, the tax system can effectively be called a manufacturing-stage VAT. The exceptions were to be two small lists— one, a list of exempt services, and the other, a negative list of services, where the tax credit mechanism would not cover taxes paid on these services.

STATE LEVEL TAX REFORMS

The introduction of state level VAT was one of the major reforms at state level in the form of replacement of sales tax. Further its introduction was very critical as it contributes 60 per cent of states' tax revenues.

The report on Reform of Domestic Trade Taxes in India prepared by the NIPFP (1994) favoured the conversion of the prevailing sales taxes in to VAT parallel to the central manufacturing stage VAT. VAT extends the sales tax up to the retail stage with credit allowed of taxes paid on purchases for all intra-state purchases. Inter-state sales tax will continue to be levied.

The salient features of the April 2005 reforms are summarized here:

— The tax is levied at two rates (except for bullion, specie, and precious metals, which are taxed at 1 percent). Basic necessities (about 75 items) are exempted. Most items of common consumption, inputs, and capital goods (about 275 items) are taxed at 4 percent, and all other items are taxed at 12.5 percent. Gasoline and diesel fuel (which contribute about 40 percent of the sales tax) are kept outside the VAT regime, and a floor rate of 20 percent is to be levied on them.

— The tax credit facility covers inputs and purchases as well as capital goods for both manufacturers and dealers. Credit for taxes paid on capital goods can be used over three years of sales.

— The tax credit mechanism operates fully only for intrastate sales. In interstate transactions, the exporting state is supposed to give an input tax credit for purchases made locally, against the collection of the central sales tax. The central sales tax credit in the importing state, or other mechanisms of zero-rating of interstate sales, will be introduced in two years, when the central sales tax in its present form will be phased out. In the meantime, an information system on interstate trade will be built up.

— The central government has agreed to compensate the states for any loss of revenue at rates of 100 percent in the first year, 75 percent in the second year, and 50 percent in the third year. The loss will be calculated by estimating the difference between the projected sales tax revenue using 2004–05 as the base and the actual revenue collected. The projected revenues will be estimated by applying the average of the best three years' growth rates during the last five years.

— Tax incentives given to new industries by different states could be continued so long as it does not break the VAT chain. Many states propose to convert tax holidays into deferment of the tax.

— All dealers with annual turnover above Rs. 500,000 are required to register for the VAT. However, the states may levy a simple turnover tax not exceeding 2 percent on those dealers with turnover up to Rs. 50 lac. Such dealers, paying the turnover tax, do not have to keep detailed accounts of their transactions. But these small dealers will not be a part of the VAT chain, and no credit will be available for the taxes paid on purchases from these dealers. They may therefore voluntarily register as regular VAT dealers.

Altogether, as on April 2005 eighteen states and five Union Territories committed themselves to implement the VAT. Haryana began to implement the VAT in April 2004, but with three main rates (4 percent, 10 percent, and 12 percent). Eight states, including Gujarat, Madhya Pradesh, Tamil Nadu, and Uttar Pradesh, have stayed out of the system. These are some of the larger states with significant industrial bases. Given the perceived incentives of VAT regime in the form of input tax credit, there are pressures on these states to join in as well. As of now 30 states and union territories have state level VAT regime.

ROAD AHEAD

Direct Taxes Code – A new paradigm in Direct Taxation

The more than four decade old Income Tax Act, 1961 will pass on the baton to the new Direct Taxes Code in 2011, if passed by the Parliament. The new Code is slim, simple, flexible and swift to win the race in the liberalized self-regulation oriented economy in the mid way of integration with the global economy. The Code is expected to be proved to be a mile stone in the journey of Direct Tax Reforms. The existing Act has added too much flab as it passed its journey through the year on year amendments and multitude of judgments delivered by the courts at different levels. Over and above, the complex process of yearly amendments required to be made in each Finance Act have rendered the Act inflexible, complex and incomprehensible to the users. The complexities have degenerated into non-compliances, tax evasions and litigations wherein the whole objective of 'collection of revenues' for the developmental needs of the society with a 'smile and satisfaction on the face' of the payer has become obscure.

The Code, as any other piece of legislation, has to pass the test of just, equity and fairness and must stand before the judicial scrutiny. The Code is being debated on these principles and the government has invited the suggestions from all the corners across the country. The proposals related to Minimum Alternate Tax (MAT), General Anti-Avoidance Rules (GAAR), Exempt-Exempt-Tax (EET) method of taxation of savings, Residential status of companies, Double Taxation Avoidance Treaties (DTAA), Branch Profit

Taxation, Taxation of Non-Profit Organisations etc. are being discussed and debated with new apprehensions. However, in view of the path breaking openness and transparency rolled out by the government before introducing the Code in the Parliament it is expected that the concerns and apprehensions of all the stakeholders will be taken care of by the government as far as possible and the new direct tax regime will meet the expectation of the stakeholders.

Goods and Service Tax (GST)

Indirect tax laws are scattered among a large number of legislations enacted by the Union and State Governments. The compliances to these laws are cumbersome and costly. Though, CENVAT credit rules and VAT are in place still cascading effect is not totally out from the final pricing.

Therefore, GST is being envisaged in the form of one uniform indirect tax regime and to do away with multiple taxes like CENVAT, Central sales tax, Value Added Tax (VAT), services tax and a number of other taxes being levied and collected by the State governments under different nomenclatures.

The GST is a comprehensive value added tax on goods and services. Through a tax credit mechanism, GST is levied and collected on value addition at each stage of the supply chain. GST paid on the procurement of goods and services can be set off against that GST payable on the supply of goods or services. The end consumer in the supply chain has to bear the tax.

It is seen as a genuine value addition tax neutralizing the cascading effect of all the indirect taxes, Central or State, therefore removing the ill-effects of the existing indirect tax regime prevailing in the country.

The government is optimistic that the new GST will be rolled out on 1st April , 2010. An Empowered Group of State finance ministers headed by Finance Minister of West Bengal, Shri Asim Dasgupta is working tirelessly to meet the target date. The Group has many challenges to be addressed to make GST a reality. Structure, rates, list of exempted items, legislative and constitutional changes are some of the issues to be settled amongst the diverse views of the different States. Shri Dasgupta played a very pivotal role in the acceptance and implementation of VAT by the States. Therefore, country can hope another mile stone in the indirect tax reform journey from him in the next financial year.

CONCLUSION

The reforms in taxes are not a one time task instead it is a continuous exercise depending upon the needs as they arise. Since independence lot of changes in taxes can be seen. Tax collection is a major source of government exchequer whether at state level or central level.

To abide by the principle of equity it is to be kept in mind that tax system should be such that it does not create unnecessary burden on the head of lower income class. Coordinated reforms should be undertaken at the central, state, and local levels. A major objective should be minimization of distortions and compliance costs. Further, the sub national tax system should be revised so that the principles of a common market are not violated.

Broadening the base of both central and state taxes and keeping the tax structures simple—within the administrative capacity of the governments is an important international lesson that should be incorporated in further reforms. Phasing out exemptions and concessions and minimizing discretion are all important not only for the soundness of the tax system but to enhance its acceptability and credibility.

The role of government is not restricted to the collection of revenue from its citizens rather its more important accountability starts from here. The accountability in government expenditure may be the next phase of reforms whereby government ensures to itself and assures to the tax payers that each rupee collected from them is being honestly and productively being spent for the 'visible' development of the country.

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DIRECT TAX CODE — AN OVERVIEW

CHITTARANJAN PAL*

"Just as one plucks fruits from a garden as they ripen, so shall a king have revenue collected as it become due. Just as one does not collect unripe fruits, he shall avoid taking wealth that is not due because that will make the people angry and spoil the very sources of revenue"- Kautilya

INTRODUCTION

"In addition to serving the primary purpose of providing sufficient revenues to the State, taxes have come to be recognised as an instrument through which the social and economic objectives of a welfare State could be achieved. They are utilized now for providing incentives for larger earnings and more savings, fostering industrial development by selective concessions, restraining ostentatious expenditure, checking inflationary pressures and achieving social objectives like equalities and the enlargement of opportunities to the common man."

Income-tax is one of the major sources of revenue for the Government. The responsibility for collection of income-tax vests with the Central Government. This tax is levied and collected under Income-tax Act, 1961.

Tax administrators, Professionals and tax payers have raised concerns about the complex structure of the Income Tax Act. In particular, the numerous amendments have rendered the Act incomprehensible to the average tax payer. Besides, there have been frequent policy changes due to changing economic environment, complexity in the market, increasing sophistication of commerce, development of information technology and attempts to minimize tax avoidance. The problem has been further compounded by a multitude of judgments rendered by the courts at different levels. Any complex tax legislation increases the cost of compliance as well as administration. Given that the cost of compliance is essentially regressive in nature, this undermines the equity of the tax system.

Over the last twenty five years, the marginal tax rates have been steadily lowered and the rate structure rationalized to reflect the best international practices. Any further rationalization of the tax rates may not be feasible without corresponding increase in the tax base. Broadening of the base is important to enhance revenue productivity of the tax system and to improve its horizontal equity.

The Finance Minister, Mr. Pranab Mukherjee on 12th August, 2009 released the draft of the 'Direct Taxes Code' and a 'Discussion Paper'. The Direct Taxes Code is designed to reflect the Principles that have gained international acceptance. The Code seeks to consolidate and amend the law relating to all direct taxes, that is, income-tax, dividend distribution tax, fringe benefit tax and wealth-tax so as to establish an economically efficient, effective and equitable direct tax system which will facilitate voluntary compliance and help increase the tax-GDP ratio. Another objective of the proposed Direct Tax Code is to reduce the scope for disputes and to minimize litigation.

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STRATEGY TO BROADENING TAX BASE

The strategy proposal under the Code for broadening the tax base essentially comprises following three elements.

The first is to minimize exemptions. For many decades, the tax base has been eroded through a steadily escalating range of exemptions. The removal of these exemptions will have consequences as under:

- Higher tax-GDP ratio;
- Enhanced GDP growth
- Improvement in equity (both horizontal and vertical)
- Reducation in compliance costs
- Reduction in administrative burdens, and
- Discouragement for corruption.

The second element of the strategy relates to the problem of ambiguity in the law which facilitates tax avoidance. Therefore, it is necessary to undertake a periodic exercise of rewriting the Tax Code in the light of new trends in interpretation by the judiciary, aggressive tax planning by taxpayers, and new opportunities for reducing compliance cost through massive induction of technology and public private partnership.

The third element of the strategy relates to checking of erosion of the tax base through tax evasion.

SALIENT FEATURES OF THE CODE

The salient features of the code are as under:

- Single unified taxpayer reporting system
- Using simple language in drafting so as to convey, with clarity, the intent, scope and amplitude of the provision of law
- Reducing the scope for litigation
- Flexibility in the structure of the statute which is capable of accommodating the changes in the structure of a growing economy without resorting to frequent amendments
- To ensure that the law can be reflected in a Form
- In order to enable a better understanding of tax legislation, provisions relating to definitions, incentives, procedure and rates of taxes have been consolidated
- Elimination of regulatory functions
- All rates of taxes are proposed to be prescribed in the First to the Fourth Schedule to the Code itself thereby obviating the need for an annual Finance Bill.
- The changes in the rates, if any, will be done through appropriate amendments to the Schedule brought before Parliament in the form of an Amendment Bill.

SCOPE OF TOTAL INCOME

The public goods and services provided by the Government are enjoyed, in general, by all persons living within that country. Therefore, it is logical for all such persons to contribute towards such public goods and services. This forms the underlying basis of the principle of residence-based taxation of income.

Special Session

Companies Bill, 2009

NEW APPROACH TO COMPANY LAW REFORMS – A STUDY OF SELECT JURISDICTIONS

CS ALKA KAPOOR*

INTRODUCTION

Growing emphasis on good corporate governance, corporate social responsibility and good corporate citizenship is predominantly influencing company law reforms the world over. Simultaneously, Company Law reforms are focusing on transparency through enhanced disclosures and increased accountability on the part of corporate management while at the same time providing a flexible regime for small and medium businesses. Modernization of company law has in fact become a part of the drive to facilitate enterprise, enhance the attractiveness of the country as a preferred destination to do business and foster business competitiveness. The overall objective is to achieve a simple, consolidated and accessible company law. Additionally, the reforms aim at cutting back on overly regulatory intervention thus providing companies with operating flexibility to function in conformity with changing environment.

The reform in Company law is in varying stages in several countries besides India viz. United Kingdom, Australia, Canada, Hong Kong, Singapore, Malaysia and South Africa. The driving forces behind company law reform, throughout these countries, are much the same: each jurisdiction recognizes the need for stronger corporate governance and seeks to address the implications of globalization and international competition, the rapid growth in the number of shareholders of companies as well as their increased sophistication, the emergence of new industries and the developments in the financial markets and in modern technology.

COMPANY LAW REFORMS IN UNITED KINGDOM

Company Law in U.K. has undergone major reform under the Company Law Review (CLR), which sought to modernize the legal framework in which companies operate. In 1998, the Government commissioned an independent Company Law Review Group, comprising experts, practitioners and business people to take a long-term fundamental look at core company law and to see how it could be brought upto date. The CLR conducted a thorough review and assessment and provided the essential blue print in the form of a Report in 2001. As a response to the final Report of the Company Law Review, the Government brought out White Paper on Company Law 2002, introducing which the then Competition Minister, Melanie Johnson stated "Our current company law is creaking with age and needs to modernize and reform. A thorough overhaul is needed to make the law clear and accessible".

The White Paper 2002 evoked huge response. Taking into consideration, the suggestions received, the Department of Trade and Industry again released the UK White Paper on Company Law, 2005 which contained draft of the Companies Bill and invited views. Consequently, New Company Law Reform Bill was introduced in Parliament in May, 2006 for discussion and approval.

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The UK Companies Act, 2006 received Royal Assent on 8th November 2006. The Act has effectively replaced existing companies' legislation by rewriting, updating and modernizing company law. The changes in the Act have been implemented in a number of phases and on October 1, 2009 virtually all sections of the Companies Act, 2006 have come into force.

Salient Features of UK Companies Act, 2006

The Companies Act, 2006, which received Royal Assent on November 8, 2006, is the most comprehensive overhaul of company law in the U.K. over the past 50 years and will have a profound impact on directors, shareholders and auditors of companies. Moving away from the common law, directors' duties have been codified and directors are required to take into consideration the interests of employees and the environment as well as shareholders in corporate decision-making. The Act also codifies case laws in certain areas. The salient features and key changes introduced through the Companies Act, 2006 include:

Object Clause

The **objects of companies formed on or after 1 October 2009 (New Companies) shall be unrestricted unless restrictions are specifically inserted into the articles.** Companies formed before that date (Existing Companies) can avoid future concerns that they are acting ultra vires by deleting all of their existing objects.

New Model Articles

There are **three new sets of Model Articles** : for a public company limited by shares; a private company limited by shares; and a private company limited by guarantee. The relevant Model Articles apply to a New Company unless its members choose to exclude or modify them.

Table A 1985 (and earlier versions) remain in force, so Existing Companies with Table A-based articles do not need to adopt new articles. They may, however, choose to update their articles by adopting some or all of the Model Articles.

Directors Duties

Directors are required under common law principles to act "in good faith in the best interests of the company." Accountability of the board to the shareholders is the central tenet of company law. This traditionally meant that the directors are required to take into consideration the interests of the shareholders as a body over employees, creditors or individual shareholders. Section 309 of the Companies Act, introduced in 1980, modified this position by requiring directors also to have regard to the interests of the employees as a whole. The directors' duty to members is also subject to their duty to act in the interest of creditors. It is unclear under existing law what happens in the event of conflict of interests between shareholders and employees who, unlike the former, have no legal means to enforce this duty.

In a radical departure from common law practice, the new Act codifies directors' duties by requiring a director "to act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole." The duty to promote the success of the company requires consideration of factors such as employee interests, the impact on the community and the environment as well as the long term consequences of a decision, relationships with trading partners, the company's reputation, the need to act fairly between members and other factors. The duty to act in the interests of creditors will continue as earlier. However, when there is a conflict of interest, the interests of the shareholders will prevail over the interests of the employees.

Importantly, the directors will be liable only to the company and not its shareholders for breach of the new statutory duty, provided the company can show that it has suffered loss as a result of the breach. The Department of Trade and Industry (DTI) will issue guidance on these controversial provisions.

An important development is that directors may now keep their home addresses private and give a service address for the public record. Companies will be required to create a new register of directors' residential addresses.

The duties of directors' as codified under the Bill include -

Duty to act within powers

Directors are under a duty to act in accordance with the company's constitution and to exercise their powers only for the purposes for which they were conferred.

Duty to promote the success of the company

This duty has two elements:

(i) a director must act in the way he or she considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole;

(ii) in doing so, the director is required to take into account the following factors:

  (a) the likely long term consequences of any decision;

  (b) the interests of the company's employees;

  (c) the need to foster relationships with customers, suppliers and others;

  (d) the impact of the company's operations on the community and the environment;

  (e) the need to maintain a reputation for high standards of conduct;

  (f) the need to act fairly as between members of the company.

Duty to exercise independent judgment

A director must exercise independent judgment and should limit his discretion unless acting in accordance with an agreement duly entered into by the company or in a way authorised by the company's constitution.

Duty to exercise reasonable care, skill and diligence

A director must exercise reasonable care, skill and diligence in the carrying out of his functions.

Duty to avoid conflict of interest

A director must avoid a situation in which he or she has, or may have, a direct or indirect conflict of interest with the company. This applies in particular to the exploitation of any property, information or opportunity. The duty is not infringed where:

(i) the situation cannot reasonably be regarded as likely to give rise to a conflict of interest; or

(ii) the matter has been authorised by the directors.

Duty not to accept benefits from third parties

A director must not accept a benefit from a third party conferred by reason of (i) his being a director, or (ii) his doing (or not doing) anything as a director.

Duty to declare interest in transactions

If the director of a company is in any way, directly or indirectly interested in a proposed transaction or arrangement with the company he must declare the extent of that interest to other directors.

Shareholders' Derivative Action

Under the earstwhile law, there was no legal right of shareholders to sue the directors on behalf of the company; however, the courts have had the discretion whether to allow such a derivative action to be filed. The 2006 Act, creates a new statutory right of the shareholders to sue directors on behalf of the company for a much broader range of conduct than that was under the common law, namely, negligence, default, breach of duty or breach of trust subject to the court allowing the action to proceed. Further, shareholders can sue the directors for negligence even if the directors have not benefited from their negligence.

In order to protect directors from spurious claims filed by opportunistic shareholders, the Act enables the courts to dismiss a claim which lacks sufficient prima facie proof in light of the documentary evidence filed by the applicant. The courts can also make costs and civil restraint orders against the applicant, and consider the evidence of independent shareholders who have no interest in the matter.

Flexibility for Private Companies

Private companies are no longer be legally required to have a company secretary. Instead, companies may appoint authorised signatories who may sign any document on behalf of the company. Directors and secretaries of public companies will automatically be authorised signatories.

Private companies are also not required to hold an annual general meeting. The prohibition on providing financial assistance for the purchase of their own shares is also removed. Rules on share capital have been simplified and new rules introduced which make it easier to pass written resolutions.

Auditors' Liability

The Act, for the first time, allows auditors to agree with their corporate clients a limit of liability in respect of an audit subject to annual shareholder approval,the limit being "fair and reasonable." In determining what is fair and reasonable, the courts may not take into account circumstances arising after the loss or damage in question has been incurred or the possibility of recovering compensation from other persons liability in respect of the same loss or damage. The Government has the power to make regulations specifying the content of the liability limitation agreements.

Disclosure of Information in Business Review

The Companies Act 1985 (Operating and Financial Review and Directors' Reports) Regulations, 2005 introduced a requirement for listed companies to produce an annual operating and financial review (OFR). The 2006 Act has exempted listed companies from the requirement to produce an OFR. However, the forward looking, non-financial reporting required by the OFR has been reintroduced in the new "business review."

In accordance with the EU Accounts Modernisation Directive, all companies, except for small companies, must publish an annual directors' report containing a business review for all financial years beginning as of April 1, 2005. Small companies are those which satisfy at least two of the following three criteria: turnover of not more than £ 5.6 million, balance sheet total of not more than £ 2.8 million and not more than 50 employees.

The purpose of the business review is to enable shareholders assess how the directors have performed their duty to promote the success of the company. The business review must contain a fair review of the company's business and a description of the principal risks and uncertainties facing the company.

The business review of listed companies must also include, to the extent 'necessary for an understanding of the development, performance or position of the company's business:' -

— the main trends and factors likely to affect the future development, performance and position of the company's business, and

— Information about environmental matters, the company's employees and social and community issues.

The Government has provided a safe harbour to limit the exposure of directors to civil liability in respect of statements or omissions made in the directors' report and directors' remuneration report. Directors will be liable only if their statements are untrue or misleading and are made in bad faith or recklessly or there is a dishonest concealment of material facts. Directors will, moreover, only be liable to the company and not to shareholders or third parties.

Indirect Investors

Indirect investors are investors who hold shares through intermediaries such as nominee brokers. In an attempt to provide voting and information rights to beneficial shareholders, the Act allows companies to amend their articles to extend rights to persons nominated by the registered member. A registered member of a listed company may only nominate the beneficial shareholder, however, anyone could be nominated by a member of an unlisted or private company.

As a result, the registered member can nominate another person to enjoy any or all of his rights such as the ability to require directors to call a meeting, or receive the annual report and accounts. The nominated person will also be entitled to be appointed as the proxy with voting rights at a meeting. However, the registered member must continue to exercise the right to transfer the shares and will be the only one to have rights directly enforceable against the company.

The Act contains a reserve power allowing the Government in the future to force institutional shareholders to disclose how they vote and any instructions given relating to their exercise or non-exercise.

COMPANY LAW REFORMS IN HONG KONG

Way back in 1984, a Standing Committee on Company Law Reform (SCCLR) was formed in Hong Kong to advise the Financial Secretary on amendments to the Companies Ordinance and other related ordinances.

The SCCLR's Report, which was published in February 2000, made 62 recommendations for reform. These had been divided into four phases, namely Phases I to IV, for follow-up action.

All the recommendations in Phase I were enacted into law through the Companies (Amendment) Ordinance 2003. Some of the recommendations in Phase II (corporate governance-related) and III (non-corporate governance issues) were included in the Companies (Amendment) Ordinance 2004.

To give effect to the remaining suggestions, in Phase IV, the Companies (Amendment) Ordinance 2005 was issued in October 2005 which came into effect from January 1, 2006.

However, intending to further streamline and modernize the company law provisions, to strengthen the existing corporate governance framework and to complement Hong Kong's role as an international financial and business centre, the Hong Kong Government decided to rewrite the Companies Ordinance and began the exercise in mid 2006.

Some key milestones of the rewrite exercise include:

— Topical public consultations on key and complex subjects in 2007 and 2008;

— Publication of a draft Bill to consult the public on all reform proposals in the fourth quarter of 2009; and

— Introduction of the new Companies Bill into the Legislative Council, tentatively, in the second half of 2010.

In March 2007, the Financial Services and the Treasury Bureau published a consultation paper in order to obtain feedback from the public on proposed changes to the accounting and auditing provisions of the Companies Ordinance. This was the first of a series of consultation papers which was followed by second consultation paper on topics such as company names, director's duties, corporate directorships and registration of charges.

The third consultation covered topics such as share capital, capital maintenance structure and statutory amalgamation procedure.

First Consultation Paper

In the first consultation paper, the main topics discussed with the public were:

— provision of accounting reference dates and periods, and changes to the rules on the financial years;

— abolishing the rule that holding companies are required to prepare their own financial accounts, provided the holding company's balance sheet is shown in its group accounts;

— changes to the director's report which shall then also include a business overview on the risks and uncertainties that the company may face and estimated future developments, while the reporting requirements of directors in smaller private companies shall be simplified;

— in order to ensure that the auditors of a company have received all relevant information, the director's report shall also include a statement on the director's awareness of accounting information that the auditors may not be aware of;

— modernising and streamlining the provisions on directors' remuneration;

— streamlining provisions on summary financial reports in order to save operating costs;

— strengthening auditors' rights, such as rights of access to information;

— relaxing rules so that more private companies are eligible to make use of simplified accounts and simplified directors' reports; and

— reviewing accounting disclosure requirements.

Second Consultation Conclusions

On 10 December 2008, the Financial Services and the Treasury Bureau (FSTB) published its second consultation conclusions on the rewrite of the Companies Ordinance (CO) covering company names, directors' duties, corporate directorships and registration of charges.

A summary of the proposals which are likely to be incorporated into a draft Companies Bill is given below:

Company Names

Shadow Companies

It is proposed that the Registrar should be empowered to act on a court order directing a defendant company to change its infringing name, and substitute its infringing name with its registration number if the company does not comply with the Registrar's direction to change its name.

The proposal is intended to address concerns that "shadow companies" exploit Hong Kong's name registration system to facilitate their counterfeiting activities in the Mainland. Shadow companies are companies with names which are very similar to existing and established trademarks or trade names of other companies who present themselves as owners of such trademarks or trade names when contracting with Mainland manufacturers to produce counterfeit products.

Currently, while the owner of a trademark or trade name can obtain a court order directing a shadow company to change its name in a legal action for trademark infringement or passing off, the Registrar has no authority to act on such court order.

Hybrid Names

In the light of the mixed feedback regarding the use of the combined form of Chinese characters and the English alphabets or words ("hybrid name"), the Companies Registry will not allow the use of hybrid names. It will, however, allow phrases such as "X 光" and " " (X-Ray and Karaoke respectively) in company names because they have no direct Chinese equivalents and they are already used in other legislation.

Directors' Duties

It is proposed that the directors' duty of care, skill and diligence should be codified in the Companies Bill, but that the fiduciary duties of directors should remain uncodified. Directors' statutory duty of care, skill and diligence will be along the lines of Section 174 of the UK's Companies Act 2006 which provides that:

(1) a director of a company must exercise reasonable care, skill and diligence.

(2) this means the care, skill and diligence that would be exercised by a reasonably diligent person with —

  (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and

  (b) the director's general knowledge, skill and experience.

Corporate Directorships

It is proposed that Hong Kong should continue to allow corporate directorships for private companies subject to the condition that every company must have at least one director who is a natural person, subject to a reasonable grace period. The proposal is aimed at ensuring that there is someone who can be held accountable for the company's actions.

Revised Registration Procedures

Registration of Instruments of Charge

Under the current registration regime, a company creating a charge is required to submit the instrument of charge together with the prescribed particulars to the Companies Registry. If satisfied that the particulars are correct, the Registrar of Companies issues a certificate of registration which is conclusive evidence that the registration requirements have been complied with. Currently, however, only the prescribed particulars (and not the instrument of charge itself) appear on the public register.

It is proposed that both the instrument of charge and prescribed particulars should be registrable and open to public inspection. The Companies Registry will no longer check the particulars of charge and will no longer issue a certificate of due registration. Instead it will only issue a certificate to establish the fact that the prescribed particulars of the charge and the instrument of charge have been delivered to the Companies Registry. The certificate will show the name of:

- the company creating the charge;

- the name of the specified form containing the prescribed particulars of the charge delivered; and
- the date on which such specified form and instrument of charge are submitted to the Companies Registry for registration.

Under the current system, registration of the particulars of charge gives constructive notice of the existence of the charge only and does not give constructive notice of the contents of the charge. If the charge instrument itself is required to be registered, it may constitute constructive notice of all the terms in the charge instrument, including negative pledge clauses, to those who may reasonably be expected to search the register, such as banks, financiers and relevant professionals.

Shortening of Time Limit for Registration

It is proposed that the five-week period currently allowed for registration of a charge should be shortened to 21 days. The proposal is aimed at reducing the period during which a charge is "invisible" to third parties.

Third Consultation Conclusions

On February 2, 2009 the Hong Kong Special Administrative Region Government released the third public consultation paper on the Companies Ordinance rewrite covering share capital, capital maintenance structure and statutory amalgamation procedure.

Several submissions were received during the three-month consultation, which ended September 30, 2008.

A key recommendation is the migration from the current par value system to a mandatory no-par value share structure. Under the existing regime, companies having a share capital are required to have a par, or nominal value, ascribed to their shares. Respondents generally agree the concept of par is no longer useful and might even be misleading.

"In addition to providing a statutory deeming provision to facilitate the migration to no par, we will allow a period of 24 months for companies to review their arrangements before migration," a Financial Services and the Treasury Bureau spokesman said.

Another recommendation is to remove the requirement for authorized capital — i.e., the maximum amount a company is permitted to raise by issuing shares. This will simplify companies' process of raising capital. Nevertheless, a company, if it so wishes, may specify the maximum number of shares it can issue in its Articles of Association.

Other recommendations involve streamlining and rationalizing some of the complex capital maintenance rules in the Companies Ordinance, including those on reduction of capital, purchase by a company of its own shares, financial assistance by a company to another party for the acquisition of its own shares and introducing a court-free statutory amalgamation procedure for the amalgamation of wholly owned, intragroup companies.

The reforms aim at simplifying the law and reducing business costs, while at the same time protecting the interests of creditors and minority shareholders.

After consultation with the Standing Committee on Company Law Reform (SCCLR) of all the public feedback, a number of recommendations will be adopted for a draft Companies Bill, which will be issued for public opinion in the fourth quarter of this year. The bill is expected to be introduced to the Legislative Council in 2010.

REFORMS IN SINGAPORE'S COMPANY LAW

The Companies Act of Singapore was first enacted in 1967. It has been subjected to numerous piecemeal amending legislations effected from time to time. In view of technological advancements, globalisation and the regional economies undergoing massive changes, the Government saw that a major revamp of the Companies Act was due.

Hence, the Company Legislation and Regulatory Framework Committee (CLRFC) was formed in December 1999. It was asked to modernise Singapore's company and business regulatory framework and to recommend one which will promote a competitive economy.

The Committee delivered its final report in early October 2002 and all its 77 recommendations were accepted by the Government. Since then the Singapore Companies Act has been amended several times to give effect to the recommendations of the CLRFC, the major ones being Amendment Acts of 2004 and 2005.

Consistent with the Singapore Government's commitment to the evolution of a corporate regulatory framework responsive to market innovation and developments in other jurisdictions as well as taking stock of changes that have taken place in the business and investment environment since CLRFC's review, the Ministry of Finance recently convened a steering committee to fundamentally review the Companies Act and to redraft the same.

The review is aimed at ensuring that Singapore has in place an efficient and transparent corporate regulatory framework that supports Singapore's growth as an international hub for both businesses and investors. The Steering Committee is assisted by five Working Groups studying five broad areas of company law.

In particular, the Steering Committee is exploring how the regulatory burdens on companies can be lessened, or the statutory requirements made easier to comply with, whilst ensuring transparency and accountability to third parties. It is also considering how 'hard-coding' too many regulatory rules in the body of the Companies Act can be avoided, and instead enable procedures to be modified as the environment changes, through changes to subsidiary legislation.

The Steering Committee has identified three key issues under the Companies Act that will be closely evaluated:

Codification of directors' duties

Currently the Singapore's Companies Act sets out only certain directors' duties, such as the duty to act honestly and use reasonable diligence in the discharge of their duties. It does not provide a comprehensive statement of directors' duties and the Companies Act must be read in conjunction with common law rules and equitable principles to obtain a complete understanding of the duties owed to a company by a director in Singapore.

The Steering Committee is evaluating whether it should follow the UK approach of setting out in the Companies Act a list of directors' duties which are derived from common law rules and equitable principles. Specifically, the UK spelt out seven duties of directors, namely the duties to act within powers, promote success of the company, exercise independent judgment, exercise reasonable skill and care, avoid conflict of interests, declare interests in proposed transactions or arrangements, and not to accept benefits from third parties. While Australia and New Zealand also adopt certain general duties as statutory duties, the UK's model is the most extensive and exhaustive.

There are both pros and cons to the UK approach. On the positive side, it helps directors to better understand the law on their fiduciary duties, which were previously difficult to interpret in light of case law. However there has been criticism that the approach may not allow for the flexibility needed to keep pace with developments and evolving practices in the business arena, and that companies would adopt a 'box ticking' approach, making reference to the consideration of all the factors required, at board meetings and in the board minutes.

Instead of codifying all the directors' duties in the Companies Act, the Steering Committee is also exploring the option of providing greater clarity to directors via practice directions or guidance notes. This is also practiced in the UK, which issues guidance notes on directors' duties, and such notes contain practical illustrations detailing the practices to adopt in actual situations such as coverage during board meetings.

Liberalisation of the financial assistance provisions

Other than in limited circumstances, it is presently an offence under the Companies Act for a company to provide direct or indirect financial assistance for the purchase of its own shares (or that of its holding companies). The application of this provision by the courts has been criticised as unclear.

Financial assistance provisions have been liberalised in a number of jurisdictions including Australia and the UK and the committee will evaluate the success of the reforms in these other countries while considering whether Singapore should follow a similar path.

Replacing the concept of the Exempt Private Company (EPC) with a "small company" definition

Finally, the Steering Committee is considering whether to introduce a "small company" definition in the Companies Act (with qualifying criteria such as total annual turnover, gross assets and number of employees) so as to reduce the regulatory burden and to simplify compliance for such companies.

Based on the current definition of an Exempt Private Company (or EPC), even large private companies in terms of assets or operations are able to enjoy the benefits of EPC status, such as exemption from filing accounts. This means that other stakeholders such as creditors, customers and employees may not have ready access to the company's financial information. Introducing a "small company" definition with appropriate qualifying criteria to replace the EPC concept, would be more consistent with the market perception of a company's size, and would recognise the interests of this broader group of stakeholders besides shareholders. Adopting a "small company" regime would also align Singapore's company law with the practices in other countries such as the UK, Australia and New Zealand.

There are however advantages to retaining the current EPC framework since it has served well in the past and it is a framework that companies in Singapore are familiar with. Here too, the Steering Committee will have to weigh the pluses and minuses of making the change.

The Steering Committee has a lot of ground to cover and it will be issuing a public consultation paper on its recommendations.

Following the completion of its deliberations, the committee will issue a public consultation paper outlining its recommendations with a view to inviting industry feedback. Such feedback will shape the drafting of an amending bill to the Companies Act. At the moment there is no publicly available timetable regarding this process.

However, this most recent review of the Companies Act to facilitate industry views and provide greater clarity is a further example of the Singapore Government's efforts to ensure a corporate regulatory framework that continues to evolve in line with international market practice.

CONCLUSION

Not only the countries discussed in preceding paragraphs, but several other countries are also in the similar process of review of their Company Law. The reform and revision of the basic legal framework for corporate entities is seen as an essential measure to achieve sustainable economic reform and relates to simplification of registration process for companies, specifying directors' duties, providing a flexible regime for small and private companies, making stringent disclosure norms for companies with larger public interest, enhancing shareholder democracy, simplification of audit requirements for small companies, recognition of e-communication and e-recording, and making the whole process compatible so as to meet future needs, challenges etc.

In tune with the international developments, the Government of India has also consequent upon a massive exercise for a comprehensive revision of the Companies Act 1956 on the basis of a broad based consultative process, introduced the Companies Bill, 2009 in Lok Sabha.

In recognition of the fact that the primary purpose of any law is to facilitate the public and bearing in mind the current international style of legal drafting, an ideal law for the corporate sector should be clear, concise and comprehensible. It is desirable that the law is a "core company law" i.e. regulating the "entity" (irrespective of its corporate structure and size) rather than its "activity" and providing the basic principles governing all aspects of the operation of corporate entities within a single, comprehensive framework.

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The principle of residence-based taxation asserts that natural persons or individuals are taxable in the country or tax jurisdiction in which they establish their residence or domicile, regardless of the source of income. In the case of artificial persons such as companies or firms, the place of incorporation or the place where control or management is exercised is deemed to be the place of residence. In the context of income tax, the ability to pay of the residents of that country is fully measured by their global income. Therefore, the principle of residence-based taxation of income envisages the taxation of global income.

However, there are individuals/entities whose "residence" is in one country but their business is actually carried on in another country and their income is earned in the latter country. In such cases, the principle of residence-based taxation would be inappropriate. The principle of source-based taxation is invariably applied to non-residents in a country and envisages the taxation of only such income which is sourced in that country.

Under the Code, residence based taxation is applied for residents and source based taxation for non-residents. A resident in India will be liable to tax in India on his world-wide income. Where as, a non-resident in India will be liable to tax in India only in respect of accruals and receipts in India (including deemed accruals and receipts).

TAXATION OF COMPANIES

Case for taxing corporate profit: Companies or corporations are the most widely used and most efficient forms of doing business. They earn huge incomes. Hence, a tax on the profit of companies is considered reasonable and just. A tax on the income of companies can also be justified as a withholding tax that, in a comprehensive and timely manner, taxes the income which would otherwise flow to the shareholders.

Dividend Distribution Tax (DDT): In theory, all profits should be distributed as dividends to the shareholders but, in the real world, only a part of the post-tax profit is distributed to the shareholders as dividend. A tax on dividend can either take the form of a tax in the hands of the shareholder at his personal marginal rate or take the form of a tax at a flat rate upon distribution of dividend by the company. The first method of taxation has been found to be administratively cumbersome and prone to leakage. The second method is administratively simple and with no possibility of leakage. Therefore, under the Code, dividends will be taxed under the second method in respect of dividend distributed by a resident company. A resident company will be liable to dividend distribution tax at the rate of fifteen per cent of the amount declared by way of dividends. Once a dividend has suffered dividend distribution tax, it will be exempt in the hands of the recipient.

Minimum Alternate Tax (MAT)

A company would ordinarily be liable to tax in respect of its total income. However, owing to tax incentives and tax evasion, the liability on total income, in many cases, has been found to be extremely low or even zero. Therefore, internationally, a variety of economic bases and methods are used to calculate presumptive income so as to overcome the problems of tax incentives and tax evasion. For example, certain presumptions are based exclusively on the taxpayers' net wealth or on the value of the assets used in his business. Other presumptions are based on the gross receipts of the enterprise; some others are based on visible signs of wealth. Standard assessment methods use several key factors and indices of profitability, which vary according to the activity, to determine the taxpayer's income.

Several countries have adopted minimum taxes based on a fixed percentage of the assets of a business. The economic rationale for the assets tax is that investors can expect ex-ante to earn a specified average rate of return on their assets. Therefore, it provides an incentive for efficiency. Accordingly, the Code provides for Minimum Alternate Tax calculated with reference to the "value of the gross assets".

The shift in the MAT base from book profits to gross assets will encourage optimal utilization of the assets and thereby increase efficiency.

"Value of gross assets" will be the aggregate of the value of gross block of fixed assets of the company, the value of capital works in progress of the company, the book value of all other assets of the company, as on the last day of the relevant financial year, as reduced by the accumulated depreciation on the value of the gross block of the fixed assets and the debit balance of the profit and loss account if included in the book value of other assets.

The rate of MAT will be 0.25 per cent of the value of gross assets in the case of banking companies and 2 per cent of the value of gross assets in the case of all other companies. Under the Code, MAT will be a final tax. Hence, it will not be allowed to be carried forward for claiming tax credit in subsequent years.

Companies like to do business in a country where regulations are simple and where there is a lot of certainty. There are a couple of things that found very interesting in the new tax code in respect of corporate income tax. First of all, the corporate income tax rate would go down to 25%, which is in line with international practice. Since a lot of exemptions are going to be abolished, the taxable base is surely going to be increased.

So, when there is reduction of the statutory corporate tax rate to 25%, it needs to bear in mind that the effective tax rate may still be quite high or even higher because of the taxable base. The tax code also propose to introduce Advanced Pricing Agreement (APA) procedure. It means that companies, especially multinational companies would be in a position to get upfront agreement and clearance on whether a transaction is taxable and how it is going to be taxed. That is a very important development and it is going to be very supportive of companies doing business in India.

It is a basic international principle that countries are free to levy tax to their residents in the way they want to do it. Tax is only one part of a choice of a company doing business in a certain location. There are other elements that play the role as well.

BUSINESS REORGANISATION

Reorganisation of a business should, ordinarily, be tax neutral. Therefore, the Code defines 'business reorganisation' as to mean reorganization of business of two or more residents, involving an amalgamation or a demerger.

Amalgamation

Amalgamation of companies has been defined to mean a merger of one or more companies with another company (amalgamated company) or merger of two or more companies to form one company (amalgamated company) subject to the following conditions:-

(a) All the assets and liabilities of the amalgamating company or companies immediately before the amalgamation shall become the property of the amalgamated company.

(b) Shareholders holding seventy five per cent or more (in value) of the shares in the amalgamating company (other than shares already held by the amalgamated company or by its nominee) shall become shareholders of the amalgamated company by virtue of the amalgamation.

(c) The scheme of amalgamation to be in accordance with the provisions of the Companies Act.

Tax Benefits from amalgamation

In terms of the Code the amalgamating and amalgamated companies shall be entitled to the following benefits in the case of business reorganisation through amalgamation:-

(a) The transfer of investment assets in amalgamation will not be considered as a transfer for the purposes of capital gains in the hands of the amalgamating company, if the amalgamated company is an Indian company.

(b) The transfer of investment assets (including shares held in an Indian company) by a foreign company to another foreign company in a scheme of amalgamation will not be considered as a transfer for the purposes of capital gains in the hands of the amalgamating company provided the scheme of amalgamation satisfies the conditions applicable to amalgamations contained in the Code.

(c) The exchange of shares in an amalgamating company for shares in the amalgamated company will not be considered as a transfer for the purposes of capital gains in the hands of the shareholders of the amalgamating company, if the amalgamated company is an Indian company.

(d) The accumulated losses of an amalgamating company shall be deemed to be the loss of the amalgamated company in the year in which the amalgamation is effected subject to fulfillment of specified conditions.

The aforesaid benefits shall be available to all companies irrespective of the nature of their business.

Demerger

The Code defines Demerger in relation to a company to mean the transfer by a company (demerged company) of its undertaking to another company (resulting company) subject to the following conditions:-

(a) The entities involved should be companies.

(b) The transfer shall be the transfer of an "undertaking". Undertaking shall include any part of an undertaking, or a unit or a division of an undertaking, or a business activity taken as a whole, but shall not include the transfer of individual assets or liabilities or any combination thereof not constituting a distinct business activity.

(c) The transfer of the undertaking is on a going concern basis.

(d) All assets and liabilities of the undertaking shall be transferred to the resulting company.

(e) The assets and liabilities of an undertaking transferred to the resulting company shall be valued at the book value as per the provisions of this Code on the date of demerger and such value shall be deemed to be the value of the assets and liabilities entered in the books of accounts of the resulting company.

(f) The resulting company shall issue shares to the shareholders of the demerged company on a proportionate basis as a consideration for the demerger.

(g) Shareholders holding not less than three-fourths (in value) of the shares in the demerged company (other than shares already held by the resulting company or by its nominee) shall become shareholders of the resulting company by virtue of the demerger.

(h) The scheme of demerger shall be in accordance with the provisions of the Companies Act.

(i) The transfer is in accordance with such other conditions as may be notified by the Central Government having regard to the necessity to ensure that the transfer is for genuine business purposes.

Tax Benefit from demerger

In terms of the Code the companies shall be entitled to the following benefits in the case of business reorganisation through demerger of an undertaking:-

(a) The transfer of investment assets in a demerger will not be considered as a transfer for the purposes of capital gains in the hands of the demerged company, if the resulting company is an Indian company.

(b) The transfer of investment assets (including shares held in an Indian company) by a foreign company to another foreign company in a scheme of demerger will not be considered as a transfer for the purposes of capital gains in the hands of the demerged company provided the scheme of demerger satisfies the conditions applicable to demergers contained in the Code.

(c) The exchange of shares in a demerged company for shares in the resulting company will not be considered as a transfer for the purposes of capital gains in the hands of the shareholders of the demerged company if the demerged company is an Indian company.

(d) The accumulated loss of the undertaking of the demerged company shall be deemed to be the loss of the resulting company in the year in which the demerger is effected subject to the fulfillment of specified conditions.

Test of continuity

Under the Code, the accumulated losses of the predecessor in a business reorganisation have been be deemed to be the loss of the successor if the successor satisfies the test of continuity of business. This test shall be satisfied upon fulfillment of the following conditions:-

(a) The successor holds at least three-fourths of the book value of the fixed assets of the predecessor acquired through business reorganization continuously for a minimum period of five financial years immediately succeeding the financial year in which the business reorganisation takes place;

(b) The successor continues the business of the predecessor for a minimum period of five financial years immediately succeeding the financial year in which the business reorganisation takes place; and

(c) Such other conditions as may be prescribed to ensure the revival of the business of the predecessor or to ensure that the business reorganisation is for genuine business purposes.

In case the predecessor is a sole proprietary concern or an unincorporated body, the loss of the predecessor will be deemed to be the loss of the successor if the following conditions are fulfilled:-

(a) the successor satisfies the test of continuity of business

(b) the share holding of the sole proprietor or the participant, as the case may be, remains fifty per cent or more of the total value of the shares of the successor company at all times during the period of five years immediately succeeding the financial year in which the business reorganisation takes place.

The benefit of set off of the unabsorbed losses of the predecessor, allowed to the successor, shall be withdrawn by making appropriate rectification.

Reporting of International Transactions to Transfer Pricing Officer

Under the Code, specified international transactions are required to be reported to the Transfer Pricing Officer (TPO).The underlying objective of creating the institution of TPO is to ensure that the arm's length price of an international transaction should be determined only by an officer with requisite expertise on the subject.

The Code proposes the following procedure for determining the arm's length price in relation to an international transaction:-

(a) International transactions, as specified in the Code, shall be reported to the TPO by the due date of filing the return of tax bases.

(b) The TPO shall, on the basis of a risk management strategy framed by the Board in this behalf, select appropriate transactions for determination of the arm's length price and serve upon the assessee the communication of such selection, within two months from the end of the financial year in which the report was filed or the information about the transaction was received.

(c) Upon selection of the international transaction, the TPO shall inform the Assessing Officer about such selection within seven days from the date on which the communication was sent to the assessee.

(d) Upon selection of the transaction, the TPO shall serve on the assessee a notice requiring him to produce evidence, if any, on which the assessee may rely in support of the computation made by him of the arm's length price in relation to the international transaction or such other material as the TPO may require.

(e) The TPO shall serve his report, determining the arm's length price, on the Assessing Officer and the assessee within forty-two months from the end of the financial year in which the international transaction was made. Such report shall be binding upon the Assessing Officer.

(f) Thereafter, the Assessing Officer shall compute the total income on the basis of the arm's length price determined by the TPO. The assessment in such cases shall be completed within three months from the end of the month in which the report of the TPO was received by the assessing officer or thirty three months from the end of the relevant financial year, whichever is later.

(g) No separate appeal will lie against the report of the TPO. However, a taxpayer will be entitled to agitate the computation of the total income, so determined by the Assessing Officer, on the basis of the arm's length price determined by the TPO.

Further, with a view to provide certainty to taxpayers in respect of tax liability arising from any future international transaction, the Code empowers the Board to formulate a scheme to enable it to enter into, with the approval of the Central Government, advance pricing agreements with taxpayers in relation to such transactions.

RELIEF FROM DOUBLE TAXATION

Ordinarily, countries follow both the principle of residence-based taxation and the principle of source-based taxation. However, if two countries tax the same income, one based on the principle of residence and the other based on the principle of source, it could lead to double taxation of the same income. Therefore with a view to avoid double taxation the countries have agreed on certain principles to avoid double taxation.

The United Nations (UN) and the Organisation for Economic Cooperation and Development (OECD) have developed a series of model treaties to avoid double taxation. India has also evolved its own model and, based on this model, entered into Double Taxation Avoidance Agreements with about 75 countries. However, it must be noted that each agreement contains some variations and exceptions that are usually the result of negotiations between India and the other country.

The double taxation agreements are of two kinds:

(i) comprehensive DTAAs covering all kinds of income; and

(ii) limited DTAAs covering only income from shipping and/or air transport.

Methods of Allocation of Right to Tax

In terms of the Code the right to tax may be allocated to either country by adopting one of the following methods:

— Full or partial rights to tax given to the country of residence, and the country of source waiving its right to tax to that extent.

— Full rights to tax given to one country based on source or residence and the other country obliged to exempt that income.

— Full rights to tax by both countries, but with the tax in the source country limited to no more than a specified level and the country of residence giving credit for the tax paid in the source country. Thus, there is a sharing of tax revenues between the two countries.

— Full rights to tax by both countries without limitation and the country of residence giving credit for tax paid in the source country.

The Code empowers the Central Government to enter into an agreement with the Government of any country in order to provide relief on double taxation and also for the purpose of exchanging information for prevention of evasion or avoidance of income tax. Further, the Code also provides that neither a double taxation avoidance treaty nor the Code shall have a preferential status by reason of its being a treaty or law. Therefore, in the case of a conflict between the provisions of a treaty and the provisions of the Code, the one that is later in point of time shall prevail.

GENERAL ANTI-AVOIDANCE RULE

Tax avoidance, like tax evasion, seriously undermines the achievements of the public finance objective of collecting revenues in an efficient, equitable and effective manner. Sectors that provide a greater opportunity for tax avoidance tend to cause distortions in the allocation of resources. Therefore, there is a strong general presumption that all tax avoidance, like tax evasion, is economically undesirable and inequitable.

The Code point out that since the liberalization of the Indian economy, increasingly sophisticated forms of tax avoidance are being adopted by the taxpayers and their advisers. The problem has been further compounded by tax avoidance arrangements spanning across several tax jurisdictions. This has led to severe erosion of the tax base.

In view of this and in line with international trends, the Code proposes to introduce a general anti avoidance rule which will serve as a deterrent against such practices.

Conditions for invoking GAAR

Under the Code, the General Anti-avoidance Rule (GAAR) will be invoked if the following three conditions are satisfied:-

(a) The taxpayer should have entered into an arrangement.

(b) The main purpose of the arrangement should be to obtain a tax benefit and the arrangement-

  (i) has been entered into, or carried out, in a manner not normally employed for bona fide business purposes;

(ii) has created rights and obligations which would not normally be created between persons dealing at arm's length;

(iii) results, directly or indirectly, in the misuse or abuse of the provisions of this Code; or

(iv) lacks commercial substance, in whole or in part.

Meaning of arrangement, etc.

An 'arrangement' will mean any transaction, conduit, event, trust, grant, operation, scheme, covenant, disposition, agreement or understanding, including all steps therein or parts thereof, whether enforceable or not. Therefore, if the motive behind individual steps is obtaining a tax benefit, but the overall scheme is not so, the individual steps will nevertheless be treated as an arrangement and the GAAR may be invoked.

An arrangement will also include any interposition of an entity or transaction where the substance of such entity or transaction differs from the form given to it.

Lack of commercial substance

The lack of commercial substance, in the context of an arrangement, shall be determined, but not limited to, by the following indicators:

(i) The arrangement results in a significant tax benefit for a party but does not have a significant effect upon either the business risks or the net cash flows of that party other than the effect attributable to the tax benefit.

(ii) The substance or effect of the arrangement as a whole differs from the legal form of its individual steps .

(iii) The arrangement includes or involves:

(a) round trip financing;

(b) an 'accommodating party',

(c) elements that have the effect of offsetting or cancelling each other;

(d) a transaction which is conducted through one or more persons and disguises the nature, location, source, ownership or control of funds; or

(e) an expectation of pre-tax profit which is insignificant in comparison to the amount of the expected tax benefit.

Tax consequences of impermissible avoidance arrangements

If the conditions specified in the 'Lack of commercial substance' are satisfied, the Commissioner will be empowered to declare the arrangement as an impermissible avoidance arrangement and determine the tax consequences of the assessee as if the arrangement had not been entered into.

Procedure for applying GAAR

The power to invoke GAAR is bestowed only upon the Commissioner of Income tax. For this purposes the Code empowers him to call for such information as may be necessary. He is also required to follow the principles of natural justice before declaring an arrangement as an impermissible avoidance arrangement. He will determine the tax consequences of such impermissible avoidance arrangement and issue necessary directions to the Assessing Officer for making appropriate adjustments. The directions issued by him will be binding on the Assessing Officer.

REFERENCE

1. Report of the Direct Taxes Administration Committee(1958-59)
2. 'Direct Taxes Code' and 'Discussion Paper on www.finmin.nic.in
3. Moneycontrol.com