CONTENTS

EMERGING ISSUES UNDER COMPANY LAW — GOVERNMENT COMMITMENT AND LEGISLATIVE INITIATIVES

V K AGGARWAL*

1. INTRODUCTION

Company Law, an ever evolving subject, has undergone major transformation in the last decade. The impetus for such transformation germinated partially from the worldwide move for market oriented polices and partially by disquieting features of globalisation, resulting into focused attention on need for Good Corporate Governance. The advancements in information technology and influence of faster means of communications over corporate operations have also provided impetus for such transformation. In other words, the paradigm shift witnessed in the global economy and corporate sector the worldover, have cumulatively presented various issues that have triggered debate and become important factors for initiating changes in Company Law in our country and abroad.

The post reforms corporate India has witnessed tremendous growth and expansion as a result of deregulation and procedural simplification of Company Law. The corporate India experienced multifaceted growth in terms of number, size, volume and extraterritorial reach. This growth can be gauged from the fact that there were 5,84,184 companies limited by shares with an estimated aggregate paid up capital of Rs. 3,39,801.6 cores. Today, the Indian corporate sector has spread its wings in other parts of the world also and even resorted to acquisitions abroad. The catalyst behind this growth has been Government's commitment to provide growth oriented policy and regulatory framework for corporates. However, this corporate growth has been punctuated by incidences of corporate failures, securities scams, vanishing companies, mismanagement, growing shareholders dissatisfaction and unethical business practices. The Enron debacle and meltdown of certain once mighty US corporations have further aggravated the situation and raised various issues of Good Corporate Governance and attracted worldwide focus.

2. INITIATIVES FOR DEALING WITH ISSUES UNDER COMPANY LAW

With a view to deal with various issues that emerged in the wake of changing corporate paradigm, the government set up committees to suggest changes in regulatory framework.

(i) Joint Parliamentary Committee on Stock Market Scam

The Parliament constituted a Joint Committee on Stock Market Scam and matters relating thereto in April 2001 to go into the irregularities and manipulations in all their ramifications including insider trading relating to shares and other financial instruments and the role of banks, brokers and promoters, stock exchanges, financial institutions, corporate entities and regulatory authorities; to fix the responsibility in respect of such transactions; to identify misuse, if any, of and failures / inadequacies in the control and the supervisory mechanisms; to make recommendations for safeguards and improvements in the system to prevent recurrence of such failures; to suggest measures to protect small investors; and to suggest deterrent measures against those found guilty of violating the regulations. The Committee has since submitted its report.

(ii) Naresh Chandra Committee on Auditor Company Relationship

The Enron debacle of 2001 and subsequent scandals triggered another phase of reforms in company law

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

with thrust on corporate governance, accounting practices and disclosures — this time more comprehensive than ever before. The Department of Company Affairs (DCA) appointed a High Level Committee headed by Shri Naresh Chandra to examine various corporate governance issues. The Committee in its report observed that while corporate governance reforms in India far outstrip that of many countries, the performance in either lags very much behind. The Committee *inter alia* recommended as follows:

Auditor-Company Relationship

The Committee in its report observed that there is a case for some judicious restrictions in order to ensure auditors independence. In this context, the recommendations include-

Disqualifications For Audit Assignments

The committee in line with international best practices recommended an abbreviated list of disqualifications for auditing assignments, which includes —Prohibition of any direct financial interest in the audit client by the audit firm, its partners or members of the engagement team as well as their 'direct relatives'; prohibition of receiving any loans and/or guarantees from or on behalf of the audit client by the audit firm, its partners or any member of the engagement team and their 'direct relatives'; prohibition of any business relationship with the audit client by the auditing firm, its partners or any member of the engagement team and their 'direct relatives'; prohibition of personal relationships; prohibition of service or cooling off period; and prohibition of undue dependence on an audit client.

Prohibited Non-Audit Services

Generally agreeing with the Ramsay Report of Australia that there is no solid evidence of any specific link between audit failures and the provision of non-audit services, the Committee however, observed that certain types of non-audit services could impair independence and possibly affect the quality of audit. Thus the Committee recommended the prohibition of certain non-audit services, such as; Accounting and bookkeeping services, related to the accounting records or financial statements of the audit client; Internal audit services; Financial information systems design and implementation, Actuarial services; Broker, dealer, investment adviser or investment banking services; Outsourced financial services; Management functions, including the provision of temporary staff to audit clients; Any form of staff recruitment, and particularly hiring of senior management staff for the audit client; Valuation services and fairness opinion.

Management's Certification in the Event of Auditor's Replacement

With a view to make management more accountable to shareholders and audit committee in the matters of replacement of auditors and also to ensure that auditors work independently and fearlessly, the Committee recommended amendment to section 225 of the Companies Act requiring a special resolution of shareholders, in case an auditor, while being eligible to re-appointment, is sought to be replaced. The Committee further recommended that the explanatory statement accompanying such a special resolution must disclose the management's reasons for such a replacement, on which the outgoing auditor shall have the right to comment. The Committee recommended that explanatory statement to be verified by Audit committee to the effect that it is 'true and fair'

Auditor's Annual Certification of Independence

The Committee believed that the independence of auditors must be renewed, even if shareholders and audit committee are satisfied about their independence. Therefore, the Committee recommended that the audit firm, before agreeing to be appointed must submit a certificate of independence to the audit committee or to the board of directors of the client company to the effect that the firm, together with its consulting and specialised services affiliates, subsidiaries and associated companies are independent and have arm's length relationship with the client company; have not engaged in any non-audit services listed and prohibited and are not disqualified from audit assignments.

Appointment of Auditors

The Committee recommended that the audit committee of the board of directors to be the first point of reference regarding the appointment of auditors and with a view to discharge this fiduciary responsibility, the audit committee should discuss the annual work programme with the auditor; review the independence of the audit firm recommend to the board, with reasons, either the appointment/ re-appointment or removal of the external auditor, along with the auditor's remuneration. The Committee, however, excluded the Government companies and scheduled commercial banks from the application of this rule.

CEO and CFO Certification of Annual Audited Accounts

While deliberating upon this issue, the Committee referred to Section 302 of the Sarbenes Oxley Act which requires CEO & CFO of all listed companies to certify to SEC about the veracity of each annual and quarterly financial reports. The Act also provides for enhanced criminal penalties for any false certification. In this context the committee rejected the institution of criminal proceedings. The Committee thus recommended for certification by the CEO (either the executive chairman or the managing director) and the CFO (whole-time finance director or otherwise) of all listed companies as well as public limited companies whose paid-up capital and free reserves exceeds Rs.10 crore, or turnover exceeds Rs.50 crore. This certification to state that they, have reviewed the balance sheet and profit and loss account and all its schedules and notes on accounts, as well as the cash flow statements and the directors' report and statements do not contain any material untrue statement or omit any material fact nor do they contain statements that might be misleading. Further these statements together represent a true and fair picture of the financial and operational state of the company, and are in compliance with the existing accounting standards and/or applicable laws/regulations and that they are responsible for establishing and maintaining internal controls which have been designed to ensure that all material information is periodically made known to them; and have evaluated the effectiveness of internal control systems of the company.

Independent Quality Review Board

The Committee emphasized on the need for quality of fiduciary intermediaries, such as Chartered Accountants, Company Secretaries and Cost Accountants and observed that until recently most countries felt no need for any kind of public oversight board as an independent organisation to regulate the conduct of fiduciary intermediaries, however, the US Corporate scandals have changed all that, raising demand for credible public oversight bodies. The Committee in this context referred to SOX Act, which requires for setting up of Public Company Accounting Oversight Board (PCAOB). The Committee deliberated upon desirability of a PCAOB like body in India and recommended the setting up of independent Quality Review Boards (QRB) one each for ICAI, ICSI and ICWAI, with appropriate legislative support.

While suggesting the disciplinary mechanism the Committee observed that the proposed mechanism is realistic and should work, given adequate funding and determination. This should bring to bear a transparent and expeditious disciplinary procedure enhancing the prestige and public trust of all the three Institutes.

Independent Directors

The issue of independent directors was elaborately discussed by the Committee. The Committee noted that the directors have fiduciary relationship with the shareholders and not the management. There are instances where the objectives of management differ from those of the wide body of shareholders. The non-executive directors must be able to speak up in the interest of the ultimate owners and discharge their fiduciary oversight functions. The Committee cited this as the reason that the independence has become such a critical issue in determining the composition of any Board.

Although independence is a bit like consumerism; very easy to understand, very hard to achieve, the Committee recommended a comprehensive definition of independent director, without compromising the spirit of independence or constraining the supply of independent directors. The Committee, however, pointed out that defining independence is not sufficient to ensure independence of judgement, because it is dependent on various factors such as the choice of directors and their skills, conduct of Board meetings; quality and quantity of financial operational and management information supplied to the Board; managements' appetite for independent evaluation and criticism of strategies and performance etc. Thus, the Committee after deliberating upon several such critical points, urged the companies in India to make a sustained effort to attract requisite talent at the Board level, so that people can contribute their expertise to make a difference not only to governance, but also to long term corporate performance.

Corporate Serious Fraud Office (CSFO)

Financial frauds in the corporate world are very complex in nature and can be properly investigated only by a multidisciplinary team of experts. The Committee in this context recognized that the investigations into recent stock market scam have underscored the limitations of a fragmented approach in our enforcement machinery and thus felt the need for more concerted approach through setting up of an office along the lines of the Serious Fraud Office in the United States. The Committee therefore, suggested setting up of Corporate Serious Fraud Office in the form of a multidisciplinary team, to investigate not only in frauds, but to direct and supervise prosecutions under various economic legislations through appropriate agencies.

The Committee expressly recommended that the Audit committees of all listed companies, as well as unlisted public limited companies with a paid-up share capital and free reserves of Rs.10 crore and above, or turnover of Rs.50 crore and above, should consist exclusively of independent directors. The Committee however, excluded those unlisted public companies, which have not more than 50 shareholders and which have not taken any kind of debt from the public, banks, or financial institutions, as long as they do not change their character, and unlisted subsidiaries of listed companies.

(iii) Naresh Chandra Committee on Regulation of Private Companies and Partnership

It is well established that the advantages conferred on the incorporated business are those of perpetual succession and limited liability and the degree of regulation is a natural concomitant to these privileges. However, the issue which have been debated some time now is that whether small private companies be subject to rigours of all provisions of laws of land, in particular Companies Act, as they are applied to those private companies, which are big in size and where the public interest is involved.

With a view to providing a simple and cost effective legal framework for private companies, the Government constituted a Committee on Regulation of Private Companies and Partnership under the chairmanship of Shri Naresh Chandra to suggest a more scientific and rational regulatory environment, the hallmark of which is the quality, rather than the quantity, of regulation.

The Committee has since submitted its report. The Committee in its report acknowledged that private companies can not be seen in isolation or as self-contained entities. As is well known, some private companies can be quite big in terms of capital employed and/or turnover. Very often they have close relationships and significant transactions with public or listed companies. In fact promoters of listed companies have often used private companies, which they own or control, indirectly, as vehicles to siphon-off funds of the listed companies. A dilemma occurs when private companies undertake activities, given their nature or size that are really akin in scale to a public company. The Committee thus addressed the issue of inter-relationship, and the possibility of misuse of private companies as vehicles of convenience, especially if regulation on such companies was further relaxed.

The Committee in this context observed that misuse of private companies by certain unscrupulous entrepreneurs should not force a majority of small private companies to having to face the extensive rigours of compliance with the law. Onerous and, at times, unnecessary compliance requirements have, in fact, inundated the offices of the ROCs with paper work, which is difficult for them to handle or file, much less examine in any meaningful way.

The areas of reforms for private companies identified by the Committee include simplifying benefits/ exemptions that can be extended to all private companies irrespective of size; and determining criteria for a private company to qualify as Small Private Company (SPC) and extending extra benefits/exemptions to them. The recommendations of the Committee focused on –

(i) providing adequate flexibility to companies/ firms conducting, or intending to conduct business or provide professional services;

(ii) providing a structural environment conducive to growth and prosperity of the entities, being mindful of the impact on various stakeholders, and effective regulation in a manner that minimizes and deters exploitation of the liberalized provisions by unscrupulous elements; and

(iii) simplifying and rationalizing entry and exit procedures (especially for non-functional companies).

Determination of Small Private Companies

Without disturbing the existing distinction between private, public and those private companies which are subsidiaries of public companies, the Committee suggested the creation of a new category of companies, called Small Private Company (SPC) and singled out this category for special treatment . Accordingly, Small Private Company is one which has a paid-up capital and free reserve of Rs. 50 lakhs or less; has aggregated annual receipts from sales/services not exceeding Rs. 5 crores; has other receipts not exceeding Rs. 5 crores; or is registered as a SSI unit, notwithstanding its paid-up capital or aggregate annual receipts. The Committee, however, expressly recommended that the moment any SPC crosses the prescribed threshold limits it will cease to enjoy the status of an SPC and exemptions available and will be treated at par with other private companies.

Exemptions to Private Companies

The Committee has recommended following exemptions to private companies.

(a) standard form for incidental objects clause

(b) validity of share transfer forms to be one year from date of presentation

(c) shifting of registered office to require approval only of board of directors

(d) advertisement in a newspaper not required for closing of registers of members and debenture holders

(e) advertisement in a newspaper not required for closing of foreign register

(f) certain details can be provided either in annual returns or director' report

(g) manner and time frame of holding EGM may be left to the company itself

(h) manner of circulation of members' resolution may be left to the company

(i) written resolution may be passed by circulation in lieu of general meetings

(j) two-member private companies can even hold AGMs by circulation

(k) no restriction on simultaneous appointment of different categories of managerial personnel

(l) no separate dividend account and trasferring the unpaid dividend amount to a special dividend account.

(m) payment of interest out of capital without Government approval may be allowed

(n) right of other persons to stand for directorship

(o) sole-selling agents may be appointed without reference to Government

(p) manner and form of appointing alternate directors may be left to the company

(q) no prior permission for remuneration including to relatives

(r) manner and form of compensating loss of office may be left to the companies

(s) small private companies should be required to hold board meetings at least once in a calendar year

(t) Private companies should provide for manner and restrictions with regard to entering into contracts of the nature mentioned under section 297 of the Act

(u) Provisions of section 302 regarding disclosure to members of director's interest in contract appointing manger, managing director, not to apply to private companies.

Limited Liability Partnership (LLPs)

The Committee also looked into the aspects of Limited Liability Partnership. The Committee recognized that in an increasingly litigious market environment, the prospect of being a member of the partnership firm with unlimited personal liability is risky and unattractive. The Committee in this context felt the need for a legal structure like Limited Liability Partnership, to encourage Indian professionals to participate in the International business community without apprehension of being subject to excessive liability. After examining the case for extension of scope of LLP to trading firms and or manufacturing firms, the committee favoured providing this route to firms providing professional services only. The Committee has thus made following recommendations regarding formation of Limited Liability Partnerships.

(i) Law to allow LLP form of organisation for professionals may be enacted.

(ii) LLP form of organisation to be extended to other businesses once it has been evaluated and tested in respect of professionals.

(iii) No limit be placed on the number of partners in an LLP.

(iv) Relations *inter se* the partners and between the partners and the LLP may be governed by individual agreements between the partners.

(v) Liability of partners for act done by one partner to be limited unless the act is carried out by the LLP itself.

(vi) Provisions related to insolvency, winding up and dissolution of companies as contained in the

Companies Act to be suitably modified for the LLPs.

(vii) Compulsory insurance to cover liability in respect of issues for which liability is otherwise limited *vis-a-vis* the LLP.

(viii) Standards of financial disclosures to be the same as or similar to that being prescribed for private companies.

(ix) Individual partners, and not the LLP to be taxed.

Recommendations regarding the Partnership Act

The Committee recognized that the Indian Partnership Act provides a comprehensive framework for contractual relationships amongst partners and the basis for most popular form of organisation for small businesses. However, this Act has not been amended since its inception. The Committee after detailed deliberations has suggested changes in the Partnership Act to provide for a legal framework for registration of charges on lines of the provisions contained in Companies Act, 1956. The rate of interest payable to a partner not to be limited to 6% but should vary according to exigencies. The right to sue a partnership firm to arise only from a contract made in course of the business.

Other Recommendations

The other recommendations of the Committee are as follows:

(i) Freedom to fix managerial remuneration should be further enlarged.

(ii) Disclosure regarding remuneration under section 217 of the Companies Act should be limited to functional directors and relatives of directors or significant shareholders.

(iii) Provisions be made in the Companies Act to provide that shareholders' agreement is a binding agreement *inter se* parties; the company shall not abet in breach of specific performance.

(iv) Independent directors should not be prosecuted who are not in whole-time employment of the company.

(v) Resignation by non-executive directors should be effective at the earliest, once it is sent to the ROC by the said director.

(vi) A new section 620D be added to the Companies Act to give Central Government the flexibility of exempting any one or more of the provisions of the Companies Act *vis-à-vis* private companies.

(vii) Regulatory regime applicable to public deposits should be the same as that for secured debentures.

(viii) Section 560 of the Companies Act be amended to provide for a simplified exit scheme for both public and private companies.

In addition to these two Committees headed by Shri Naresh Chandra and one Joint Parliamentary Committee, earlier the Government also (i) constituted Justice V B Eradi Committee on law relating to Insolvency and Winding up of Companies; (2) Y K Alag Committee on framing legislation to enable incorporation of cooperatives as companies and conversion of existing cooperatives into companies etc.; and (iii) R D Joshi committee to examine remaining provisions of the Companies Bill, 1997.

All these Committees have since submitted their reports, following paragraphs analyses the initiatives taken by the Government in implementation of the recommendations of these Committee.

3. LEGISLATIVE INITIATIVES FOR COMPATIBLE COMPANY LAW

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

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

The amendment of 1999 brought about number of important changes to tailor the Companies Act in consonance with the then prevailing economic environment and to further Government policy of deregulation and globalisation of economy.

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

With a view to expedite the harmonization process, the Companies Act was further amended in the year 2000 to provide certain measures of good corporate governance and for ensuring meaningful shareholders' democracy in the working of companies. The amendments effected in the year 2000, included *inter alia* setting up of Audit Committee, introduction of Postal Ballot and Shelf Prospectus, abolition of the office of the Public Trustee, abolition of the concept of "Deemed Companies", appointment of auditors in the Government companies directly by the Comptroller and Auditor General of India, restricting a person to become director in more than 15 companies, prohibiting an auditor to hold securities carrying voting rights, introduction of secretarial compliance certificate to ensure better compliance of Companies Act by smaller companies, deletion of redundant provisions relating to managing agents, secretaries and treasurers and increase in penalties by way of fine to ten fold.

Thus with the globalization and growing competition and emerging new opportunities the Companies Act, 1956 is undergoing frequent changes in the last few years. The Act has been amended in 1996,1999, 2000, 2001, 2002 (twice) and Companies (Amendment) Bill, 2003 is pending with the Parliament. Various issues have been realized and new concepts and innovative provisions have been recently introduced through amendment in the Act, such as buy-back of securities, sweat equity shares, passing of resolutions by postal ballot, shares with differential rights, audit Committee, directors' responsibility statement, shelf prospectus, establishment of National Company Law Tribunal, liquidators from panel of professionals, producer companies and Compliance Certificate.

The Companies (Amendment) Bill, 2003 - Latest Legislative Initiative

The Companies (Amendment) Bill, 2003 is the latest legislative initiative towards dealings with emerging issues under Company Law to implement the findings of Naresh Chandra Committee on Corporate Audit and Governance, the recommendations of Joint Parliamentary Committee which examined the recent Stock Market Scams and R D Joshi Committee on remaining provisions of Companies Bill, 1997. The Bill seeks to introduce 174 amendments to the Companies Act, 1956.

New Sections Under the Bill

The Bill seeks to add following new Sections to the Companies Act, 1956:

Sections 2(1A), 2(9A), 2(9B), 2(10B), 2(19AA), 2(39A), 83A, 152AB, 169A, 212A, 215A, 226A, 248, 252A, 280, 383B, 383C, 391A, 395A, 609A, 615A, 629B and 629C.

Sections proposed to be deleted

The Bill seeks to delete Sections 2(14), 2(27), 15, 15A, 15B, 294A and 294AA.

Sections proposed to be substituted

The Bill seeks to substitute Sections 2(8), 2(15), 2(19AB), 2(36), 13, 30, 53, 60, 61, 67, 68, 68A, 69, 71, 72, 73, 76, 79, 81, 82, 83, 108, 133, 138, 153, 159, 205, 233, 252, 266, 275, 276, 285, 294, 316, 317, 383A, 560 and 610.

Sections amended

The Bill proposes to amend several other sections through additions, omissions, substitutions or renumbering which are as follows :

Sections 2(1AAA), 2(19AAA), 2(22), 2(30), 2(33), 3, 4, 5, 10, 11, 22(1), 25, 32, 39, 40, 42, 51, 52, 56, 57, 58, 62, 63(1), 64, 70(8), 75, 77, 78(2)(e), 80(6), 80A(1), 84, 87(1), 93, 94(1), 95, 97(1), 107(5), 108-I, 111(1A), 113, 114(4), 115(7), 116, 118(1), 119(5), 121(6) 123(4), 127(1), 128, 146(1), 149, 160, 161, 162, 163(1), 165, 169, 173, 175(1), 176(5)(c), 188(6), 189(2)(a), 190, 192, 193(6), 197, 200, 203, 206A, 209, 210, 211, 212, 215, 217, 219, 220, 223, 224, 225, 226, 227, 228, 232, 233A, 233B, 234A, 240A, 250, 256, 257, 259, 260, 270, 274, 279, 283, 284, 286, 289, 292, 292A, 293, 295, 297, 299, 300, 301, 303, 304, 305, 309, 313, 314, 349, 372A, 386, 388, 388B(2), 388C(1)(c), 390(b), 391, 393(1)(a), 394, 402(ff), 408(4).

In a nutshell the major changes proposed in the Bill through its 174 clauses are:

(i) provision for maintenance of 'book and paper', 'book or paper', 'documents and registers' in electronic form;

(ii) expansion of list of 'Officer in default';

(iii) deletion of provisions relating to acquisition and transfer of shares;

(iv) provision for appointment of independent directors and women directors on the Board of Directors of a public company;

(v) provision for appointment of Chief Accounts Officer;

(vi) preparation of consolidated accounts by holding company;

(vii) prohibition of a business, financial employment or personal relationships between the auditor and t he company of which a person is an auditor;

(viii) prohibition of carrying out certain non-audit services;

(ix) expanding scope of special audit

(x) certification of documents by Company Secretaries in certain cases;

(xi) provision for composition and independence of audit committees;

(xii) conferring power upon the Central Government to order 'compliance audit' in certain circumstances;

(xiii) conferring power upon the Central Government to attach bank accounts if there are reasonable grounds to believe that the provisions of the Companies Act, 1956 have been violated.

Analysis of Major Provisions of the Bill

Meaning of "officer who is in default" (Section)

The Bill proposes to add the following new category of persons as officer in default:

(i) any other director in respect of contravention committed with his consent or connivance or is attributable to his neglect;

(ii) the Chief Accounts Officer;

(iii) every employee who is in receipt of remuneration more than the remuneration drawn by the MD / WTD and who himself or along with his spouse and dependent children holds not less than two per cent of the equity share capital;

(iv) the share transfer agents, bankers, registrars to the issue, merchant bankers, in respect of the issue or transfer of any securities of the company;

(v) debenture trustee;

The proposal will make the officers included in the definition more accountable and responsible. *(Based on the recommendations of R D Joshi Committee)*

Prohibition of associations and partnerships exceeding certain number (Section 11)

It is proposed that a firm or association of professionals carrying on the profession of advocates, CA, CS, CWAs, doctors, architects, and any other specified profession can consist of 50 persons.

This provision has been made to help growth of firms of professionals in wake of GATS and increasing competition from international professional firms. *(Based on the recommendations of R D Joshi Committee)*

Restrictions on purchase by company, or loans by company for purchase, of its own or its holding company's shares (Section 77)

In terms of the proposed amendment to Section 77, in sub-section (1) the words 'directly or indirectly' are proposed to be inserted and a new sub-section (1A) is proposed to be inserted in section 77. It provides that if the payment is made by a company to the broker or sub-broker and he purchases the securities of the company it would amount to buy back, if broker does not earmark the funds received from such company or does not return the funds and the securities of the company were purchased by that broker out of the payments received by him. *(Based on the recommendations of Joint Parliamentary Committee)*

Obligation to reconcile securities with depository (Section 83A)

A responsibility is proposed to be cast on every company to reconcile within such period as may be prescribed the total securities issued with securities in demat form plus physical form, to avoid mismatch.

Register and index of members and holders of securities to be in electronic form (152AB)

It is proposed that a company can keep a record of the particulars of its members and holders of its debentures in computer floppies or diskettes or as well as in other electronic mode as may be prescribed. *(Based on the Companies Bill, 1997 and the recommendations of R D Joshi Committee).*

Annual Return to be made by a company (Section 159)

The provisions contained in sections 159 to 162 of the Act are proposed to be clubbed in new section 159. New provisions are proposed to be inserted to the effect that (i) the annual return will include register of members/ debenture holders containing names of 500 members / debenture holders who hold the largest number of shares/debentures or the actual number of members/debenture holder whichever is lower; (ii) particulars relating to foreign depository receipts issued by the company; (iii) particulars of Chief Accounts Officer along with the particulars of directors and secretary; (iv) particulars of every employee earning remuneration in excess of that drawn by the MD/WTD/ Manager and holding along with his spouse and dependent children not less than two per cent of the equity shares of the company.

It is proposed to provide that the Annual Return will have to be certified by a Secretary in whole-time practice if annual return is filed by a public company. Presently, the requirement of certification is applicable to only listed companies.

Failure to comply with the provisions of this section will attract a penalty equivalent to 0.001 per cent of authorized capital or Rs.500 for every day, whichever is higher. The period of filing of annual return is proposed to be reduced from 60 days to 30 days from the date of Annual General Meeting. It is also proposed that the annual return shall be in such form as may be prescribed.

Consolidated Accounts (Section 212A)

It is proposed to insert a new section 212 A providing for preparation of consolidated accounts. Accordingly, a holding company instead of preparing separate annual accounts for itself and each of its subsidiary companies shall have to prepare consolidated annual accounts for itself and its subsidiaries with effect from such date as notified by the Central Government.

A holding company may, pending such notification, opt for such consolidated accounts. Where a holding company opts for such consolidated accounts, it shall not be necessary for it to attach documents relating to its subsidiary/subsidiaries to its balance sheet.The consolidated accounts shall be prepared in the prescribed format comprising consolidated balance sheet and profit and loss account. The consolidated accounts shall comply with the provisions of Schedule VI.

However, it may be noted that the preparation of consolidated annual accounts by a holding company will not do away with the requirement of preparation of annual accounts by its subsidiary as each company to comply with the requirements of section 210 of the Act.

Chief Accounts Officer (Section 215A)

This is a new provision whereby a public company with a paid-up share capital of Rs.3 crore or more as may be prescribed will be required to have a whole-time qualified accounts officer known as chief accounts officer (CAO). He shall be a member of ICAI or ICWAI. The Chief Accounts Officer shall be responsible for proper maintenance of the books of accounts, ensuring proper disclosure of all required information indicated in the prospectus or any other offer document. He shall also ensure compliance of the provisions of this Act relating to the annual accounts of the company and shall be responsible for the preparation of annual accounts of the company. *(Based on the recommendations of Naresh Chandra Committee and R D Joshi Committee)*

Qualifications and disqualifications of auditors (Section 226)

The Bill proposes to insert a new clause (f) in sub-section (3) of section 226 which provides for additional disqualifications of auditors. Accordingly, the following person shall not be qualified for appointment as auditor of a company:

(i) who has any direct financial interest in the company;

(ii) who receives any loan or guarantee from or on behalf of the company;

(iii) who has any business relationship (other than as an auditor);

(iv) who has been in employment in the company; and

(v) whose relative is in employment in the company.

If a person receives or proposes to receive more than 25% of his total income in any financial year as his remuneration from a company he shall be disqualified from being appointed as an auditor of such company. It is also proposed that the aforesaid provisions shall not apply to an auditor during the initial five financial years from the date of commencement of the profession by such auditor or to an auditor whose total income is less than fifteen lakh rupees in any financial year. *(Based on the recommendations of Naresh Chandra Committee)*

Prohibition to provide services other than audit (Section 226A)

The Bill proposes to prohibit the auditors to render certain services to the auditee company. The services covered under the provision are accounting and book keeping services, internal audit, financial information systems design and implementation including services relating to information technology system, actuarial services, broker or intermediary or investment advisor or investment banking services, outsourced financial services, management functions, staff recruitment and valuation services. *(Based on the recommendations of Naresh Chandra Committee)*

Power of Central Government to direct special audit in certain cases (Section 233A)

The proposed amendment in section 233A seeks to lay down additional grounds whereupon the Central Government can order for any kind of audit viz. special audit, cost audit or secretarial audit of company's accounts, for a prescribed period(s) to be conducted by a Chartered Accountant, Company Secretary or Cost and Works Accountant. The additional grounds are that the management of the company is conducted in a manner, prejudicial to the interests of holders of securities or development of securities market or creditors of the company or public interest or the management has indulged in insider trading or market manipulation or the contravention of provisions relating to accounts and audit have eroded the faith and confidence in management of the company. *(Based on the recommendations of Naresh Chandra Committee)*

Minimum number of directors (Section 252)

The Bill proposes to substitute new section for the existing section 252. It is proposed that every public company having a paid-up capital and free reserves of rupees five crores or more or having a turnover of rupees fifty crores or more, shall have at least seven directors. Of these seven directors, the majority should comprise of independent directors with such number of women directors as may be prescribed. If such a public company has more than 7 directors, it shall have such number of woman directors and independent directors as may be prescribed. Every other public company shall have minimum three directors. No public company shall have more than 15 directors.

However, companies having less than 50 shareholders and not having any debt or funding from public or banks or public financial institution shall not be required to have minimum seven directors or independent directors. Every private company shall have atleast 2 directors. All existing companies shall have to comply with the above requirement within the prescribed period. *(The proposed amendment is based on Naresh Chandra Committee's recommendation)*

The Department related Parliamentary Standing Committee on Home Affairs in its 64th Report on the Companies (Second Amendment) Bill, 1999 in the context of giving representation to the small investors on the board of directors, expressed the view that since a large number of women professionals are entering the arena of corporate management, giving them adequate representation on the board of directors of a company should be considered by the Government.

The New York Stock Exchange in its principal text of the rule filing submitted to the SEC on April 4, 2003 recommended that listed companies must have a majority of independent directors.

Norway requires 40% female representation on corporate boards.

Independent directors (Section 252A)

A new section 252A is proposed to be inserted after section 252. The proposed section enlists eleven parameters for being ineligible to be appointed as 'independent director'. Any one of the eleven parameters provided in the proposed section shall suffice for making a person ineligible for appointment as independent director.

It is further proposed that to be appointed as an independent director, a person must have undergone training from a recognized Institute within a period of two years prior to his appointment. However, he may take the training within eighteen months of his appointment from a notified Institute. If he does not undergo the training, he shall cease to be an independent director and would not be eligible for appointment as independent director in any company but he may continue as a director in that company. All existing independent directors are also required to undergo training from the date as may be notified by the Government.

Listing requirements of Kuala Lampur Stock Exchange provide that directors of public listed companies must attend training programmes prescribed by it. The proposal for training of directors is to safeguard their own interest and to give them the requisite comfort level. There have been many instances when senior retired bureaucrats, Ex-Army Officers were prosecuted because of sheer ignorance of law as to their duties and liabilities as directors.

The training could be imparted through distance learning or e-learning mode. The basic objective being to apprise the directors of their duties, liabilities and responsibilities under the various corporate laws. It may also be provided that the Government may exempt qualified professionals from this requirement and deem them to have completed the training.

(The proposed amendment is based on Naresh Chandra Committee's recommendation)

Retiring Age of directors (Section 280)

It is proposed to provide a retiring age for directors. According to the new section 280, no person shall be eligible to hold office as a MD/WTD or other director or manager of a company if he has attained the age of seventy-five years. A person holding the aforesaid position on the commencement of the Amendment Act shall continue to hold such office until the expiry of his term. These provisions will not apply to a private company.

The position of a managing director, whole-time director, director or manager of a company is a strategic position requiring shouldering of onerous responsibilities.

Section 293 of the UK Companies Act, 1985 provides for the age limit of 70 years for a person to be appointed director in a public company or a subsidiary of a public company. However, under the UK Companies Act, 1985 a director can be appointed at any age if his appointment is approved by the company in general meeting and a special notice is given to the members stating the age of the person. Section 133 of the Mauritius Companies Act also provides age limit of 70 years in the case of a public company.

(The proposed amendment is based on R D Joshi Committee's recommendation)

Inter-corporate loans and investments (Section 372A)

According to the proposed amendment Central Government may prescribe for certain class of companies like stock brokers or any other intermediary, the limits upto which they may receive inter corporate loans or deposits or extent to which they may make loans or inter corporate deposits or inter corporate investment. A sub-section (9A) to Section 372A is proposed to be inserted wherein a company can make investments only through one investment company.

The proposed restriction is only where funds are sought to be placed at the disposal of investment company whose principal business is acquisition of shares or debentures or other securities. There will not be any restriction on a company directly subscribing, purchasing or acquiring securities of other bodies corporate which are not investment companies. There is also no restriction on a company forming subsidiaries which are not investment companies. The proposal is essentially to facilitate monitoring of funds and to identify diversion of funds through the route of Investment Company.

(The proposed amendment is based on recommendations of Joint Parliamentary Committee)

Certain companies to have secretaries (Section 383A)

It is proposed to substitute the existing section 383A with a new section. Following are the proposed changes:

(1) The words 'shall have a whole-time secretary' in sub-section (1) are proposed to be substituted by the words 'shall employ a whole-time secretary'. The effect of this provision is that, it clarifies that the whole-time secretary is necessarily to be an employee of the company.

(2) It is being specifically provided that a Company Secretary within the meaning of the Company Secretaries Act 1980 can be appointed as a whole-time secretary of the company.

(3) It is proposed to delete the restriction that where the Board of Directors of such company comprises only two directors, neither of them shall be the secretary of the company.

(4) The functions of a Company Secretary in employment are proposed to be specified. It is proposed to clarify that by virtue of specifying functions of Company Secretary, no managing

director or whole-time director or manager shall be deemed to be free of any liability under any other provisions of the Act.

(5) It is proposed that the requirements of obtaining compliance certificate will apply to companies having such paid-up capital as may be prescribed. Presently this requirement is applicable to every company not required to employ a whole-time secretary and having a paid-up share capital of ten lakhs rupees or more.

(6) It is proposed to do away with the defences provided under proviso to sub-section (1A) for not appointing a whole-time secretary as the same are being grossly misused.

Power of Central Governmnent to direct secretarial audit in certain cases (383B)

It is proposed to provide that the Central Government may prescribe Secretarial Compliance Audit to be conducted by a company secretary in certain cases i.e. where the affairs of the company are not being conducted in accordance with the provisions of the Act. The Central Government shall appoint a Company Secretary to conduct such audit. The Company Secretary shall submit the report of the secretarial compliance audit to the Central Government .On receipt of the report, the Central Government may take such action on the report, as it considers necessary. The expenses of audit including remuneration of the Company Secretary shall be determined by the Central Government. The term secretarial compliance audit is also proposed to be defined under explanation to the section

(This provision is based on the recommendations of Naresh Chandra Committee)

Pre-Certification by Company Secretary (383C)

It is proposed to insert a provision to provide pre-certification of documents forms, returns required to be filed with Registrar or any statutory authority by a company secretary in practice in such form and manner as may be prescribed. *(This amendment is based on Naresh Chandra Committee's recommendation)*

GLOBAL DEVELOPMENTS

Sarbanes- Oxley Act, 2002

The Enron debacle and subsequent scandals involving large US Corporations triggered another phase of reforms in corporate Governance, accounting practices and disclosures. Within a year of Enron debacle the Sarbanes-Oxley Act of 2002 was passed on July 25, 2002. The Act brought out fundamental changes in virtually each area of corporate governance and represents sweeping legislation intended, among other things, to hold corporate executives and auditors more accountable to the shareholders of public companies. The key provisions of the Act, which have potential of far-reaching effects, are given below :

Directors and Senior Executives of Public Companies

The SOX Act imposes on directors and senior executives of public companies new obligations and restrictions. The Act requires CEOs and CFOs to make extensive certifications in respect of each annual and quarterly report filed with the SEC. A CEO or CFO who knows a certification is wrong may be subject to a fine of up to $5,000,000 and imprisonment of up to 20 years. Other significant provisions that apply to the directors and senior executives of the public company are :

— prohibition on loans to directors and executive officers unavailable to outsiders;

— forfeitures by CEOs and CFOs of incentive pay and securities trading profits when there are accounting restatements based on misconduct;

— ban on trading by directors and executive officers in a public company's stock during pension fund blackout periods;

— prohibition of improper influence by directors and officers in the conduct of audits;

— authority for barring persons from serving as officers and directors of public companies; and

— acceleration of reporting deadlines for trades of company stock by directors, executive officers and 10% equity holders to as short as two days.

Audit Process and Oversight

The Act establishes the Public Company Accounting Oversight Board (PCAOB) to oversee independent auditing firms of public companies, both in the United States and abroad. Specific independence provisions restrict firms from engaging in non-audit services.

The Act casts upon outside auditors greater accountability towards audit committees. The Act requires members of the audit committee to be independent and grants audit committees the authority to engage independent counsel and advisers. Audit committees are also required to establish procedures to protect corporate "whistleblowers". The Securities

Exchange Commission has been put under obligation to direct national securities exchanges to prohibit listing any security of a public company that fails to comply with these provisions. The Act stipulates that the SEC must require annual "internal control reports," subject to management assessment and outside auditor attestation. CEOs and CFOs have been required to certify the effectiveness of internal controls on a quarterly basis.

Disclosures by Public Company

The SOX Act contains various provisions regarding SEC review of and rules for public company disclosure. It is worth mentioning that the Act empowers the SEC to require public companies to disclose material changes in financial condition or operations on a rapid and current basis, and also to review disclosures made by public companies at least once every three years. Other disclosures include off-balance sheet transactions; audit Committee financial expertise; codes of ethics for senior financial officers; and pro forma financial disclosures.

Public Company Accounting Oversight Board (PCAOB)

The SOX Act provides for establishment of five-member Oversight Board as a non-profit entity, to create a more uniform, comprehensive and detailed oversight regime for the process of auditing public companies. The PCAOB is funded by fees from accounting firms and public companies, has been empowered to make rules for auditing, quality control and ethical standards for registered public accounting firms and to inspect, investigate and impose sanctions on such registered accounting firms. However, the actions of PCAOB have been subject to the review by SEC. In fact no rules of the Oversight Board may become effective without the approval of the Securities Exchange Commission.

Enforcement and Penalties

The SOX Act provides for new penalties aimed at corporate disclosures and individual wrongdoers. CEOs and CFOs, who are now required to certify financial reports of their companies, may be liable to severe fines and prison sentences of up to 20 years for failure to comply with the requirements of the Act. The Act makes it mandatory for auditors of public companies to retain their records for five years after an audit, failing which they may be sentenced to imprisonment. The Act makes an individual liable to fine and an imprisonment upto 20 years if such person alters or destroys records in order to impede an official investigation. The Act also imposes or increases penalties for other white-collar crimes, such as securities, mail and wire fraud.

Miscellaneous

The Act requires attorneys who are appearing before the SEC, to report violations of securities laws and breaches of fiduciary duty by a public company or its agents to the chief legal counsel or CEO of the company.

White Paper on Modernising Company Law

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

With a view to increase transparency, the White Paper proposes that company constitutions be a simple document. Provision for simpler, clearer models for both private and public companies; AGMs to be held within six months of the financial year end for public companies and ten months for private companies; shareholders to be able to require a scrutiny of a poll, and proxies to have extended rights.

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

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

International Survey of Companies Law in Commonwealth, North America, Asia and Europe

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

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

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

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

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

REFERENCES

1. The Companies Act, 1956.
2. The Companies (Amendment) Act, 1996.
3. The Companies (Amendment) Act, 1999.
4. The Companies (Amendment) Act, 2000.
5. The Companies (Amendment) Act, 2002.
6. The Companies (Second Amendment) Act, 2002.
7. The Companies (Amendment) Bill, 2003.
8. Report of the Joint Parliamentary Committee on Stock Market Scam (2003).
9. Report of the Naresh Chandra Committee on Auditor Company Relationship (2003).
10. Report of the Naresh Chandra Committee on Regulation of Private Companies and Partnerships (2003).
11. Report of Justice V. Balakrishna Eradi Committee on Law relating to Insolvency and Winding up of Companies.
12. Modern Company Law for a Competitive Economy (An International Survey of Companies Law in the Commonwealth, North America, Asia and Europe (DTI, London, August, 1998).

13. Modernising Company Law – White Paper presented by the Secretary of State for Trade and Industry (July 2002).

14. Report of the R D Joshi Committee on the Companies Bill, 1997 (2002).

15. International Company and Commercial Law Review, A Sweet & Maxwell Publication.

16. Dr. S D Israni & K Sethuraman, "The Companies (Amendment) Act, 2000—A Critical Analysis" *Chartered Secretary*, Dec. 2000.

17. Dr. S P Narang — Highlights of the Companies (Amendment) Bill, 2001, Companies (Second Amendment) Bill, 2001 and Sick Industrial Companies (Special Provisions) Repeal Bill, 2001, *Chartered Secretary*, Sept. 2001.

DEVELOPMENTS IN CORPORATE LAWS

DR S K DIXIT* & PURUSHOTTAM GROVER**

1. INTRODUCTION

The world is moving at a breakneck speed towards the new economic order following the implementation of WTO agreements. If any country wants to keep pace with this changing world economic order, it has to make all relevant arrangements to face the challenges looming. Consequently, member countries have started the process to amend their legislation's governing trade and industry to keep them in line with the new system.

One of the most conspicuous feature in the worldwide development of modern society is what generally referred to as globalisation. John Baglis and Steve Smith defined the globalisation as the process of increasing interconnectedness between societies. A globalised world is one in which political, economic, cultural and social events in one part of the world have an effect on people and societies far away. In each case the world seems to be shrinking and we are witnessing the emergence of global village.

The advancements in communication and information technology is the striking feature of contemporary society. The transfer and transmission of large volumes of data and information to remote corners of the world has brought about a qualitative change in economic, social and political thinking. Capital markets have been practically interconnected. As news spreads all over the world within moments, distance loses its importance. The violation of human rights and destruction of environment become equally important, whether they occur in a neighbouring country or at the other end of the world.

Similarly as a consequence of increasing interconnectedness and interdependence the structures of national governance are all for change in the course of globalisation. The quest for more mobility and efficiency is compelling the nations to open up their borders and allow globalisation to expand and grow, however, within the national governance system.

As the globalisation requires a national governance system to conform to global norms, the agenda for market oriented reforms process encompassed legislative reforms, complementing and supplementing the policy orientations to meet the desired objectives of the whole process.

2. CORPORATE LAWS REFORMS IN INDIA

With the initiation of economic reforms process in July 1991, the Government has initiated the process of Legislative Reforms to suit the changing policy orientation and to fulfill its obligations under WTO. In the process, the Government enacted various new laws, amended existing legislations and some Bills are awaiting nod of Parliament, to provide a conducive economic and corporate legal environment. Some of them are enumerated below:

(a) Enactment of New Legislations

(i) Securities and Exchange Board of India Act, 1992

(ii) Depositories Act, 1996

(iii) Arbitration and Conciliation Act, 1996

(iv) The National Environment Appellate Authority Act, 1997

(v) Trade Marks Act, 1999

(vi) Foreign Exchange Management Act, 1999

(vii) Telecom Regulatory Authority Act, 1997

(viii) Insurance Regulatory and Development Authority Act, 1999

(ix) Central Electricity Regulatory Commission Act, 1999

---

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

(x) Geographical Indications of Goods (Registration and Protection) Act, 1999

(xi) Information Technology Act, 2000

(xii) Designs Act, 2000

(xiii) The Semiconductor Integrated Circuits Layout Designs Act, 2000

(xiv) The Protection of Plant Varieties and Farmers' Rights Act, 2001

(xv) Securitisation Act, 2002

(b) Amendments to Existing Legislations

(i) The Indian Electricity (Amendment) Act, 1991.

(ii) The Electricity (Supply) (Amendment) Act, 1991.

(iii) Sick Industrial Companies (Special Provisions) (Amendment) Act, 1993

(iv) Monopolies and Restrictive Trade Practices Act, 1969 (amended in 1991 & 1993)

(v) Motor Vehicle Act, 1988 (Amended in 1994)

(vi) National Highways Act (Amended in 1995)

(vii) Securities (Contracts) Regulations (Amendment) Act, 1996.

(viii) Securities laws (Amendment) Act, 1999

(ix) Companies (Amendment) Act, 1966, 1999, 2000, 2001, 2002 (twice)

(x) Copyright (Amendment) Act, 1994 & 1999

(xi) Patents (Amendment) Act, 1999

(xii) Code of Civil Procedure (Amendment) Act, 1999

(xiii) The Recovery of Debts Due to Banks and Financial Institutions (Amendment) Act, 2000

(xiv) Consumer Protection (Amendment) Act, 2002

(xv) Negotiable Instruments (Amendment) Act, 2002

(c) Major Bills Pending Before Parliament

— Companies (Amendment) Bill, 2003

— Securities Laws (Amendment) Bill, 2003

3. REFORMS IN COMPANY LAW

The Companies Act, 1956 was enacted with a view to consolidate and amend the law relating to companies and certain other associations. Since its inception, the Act has been amended on various occasions to keep pace with the changing business and economic scenario, emergence of professionalism and spread of portfolio awareness etc. In the early 1990s, a need was felt to harmonise the Companies Act with the developments taking place the world over to put in place a homogenous regulatory framework for the growth of Indian Corporate sector, and this was reflected in the Companies Bill, 1993. However, in August 1996, a working Group was constituted which submitted its report in 1997. On the basis of this report the Companies Bill, 1997 was introduced in the Parliament which was referred to the Standing Committee. In the mean time, with a view to tailor the Companies Act to cope up with the changing corporate environment, the Government amended the Act in the year 1996, 1999, 2000, 2001 and 2002 and give effect to various provisions of the Bill of 1997, besides introduction of new provisions. Presently, a Bill to further amend the Companies Act is pending in the Parliament. A brief description of Amendment Acts and the Bill of 2003 is given below :

(a) Salient Features of The Companies Bill, 1997

The main features of the Bill were :

(i) Classify public companies as listed and unlisted companies.

(ii) Self-regulation without Government control.

(iii) Allow SEBI to have administration and supervision (including powers to prosecute) of work relating to issue of securities and other related matters in case of listed public companies. [Certain powers were given to SEBI in this regard through Companies (Amendment) Act, 2000].

(iv) Permit companies to make inter corporate loans/investments without the approval of the Central Government. [Allowed by Companies (Amendment) Act, 1999].

(v) Prescribe minimum paid-up capital requirement for public and private companies. [Prescribed by the Companies (Amendment) Act, 2000].

(vi) Constitution of a Company Law Tribunal replacing the existing Company Law Board. (NCLT set up by Companies [Second Amendment) Act, 2002].

(vii) Provide nomination facility [*Allowed by Companies (Amendment) Act, 1999].*

(viii) Make it mandatory in all listed and unlisted companies with a paid-up capital of at least Rs.1 crore to appoint a Company Secretary.

(ix) Make it mandatory for every company not required to employ a whole-time secretary and having a paid-up capital of Rs.10 lakhs or more to attach with the Board's report a certificate from a secretary in whole-time practice *[Provided by the Companies (Amendment) Act, 2000].*

(x) Permit buy-back of securities *[Allowed by Companies (Amendment) Act, 1999]*.

(b) The Companies (Amendment) Act, 1996

The Companies (Amendment) Act, 1996 allowed the companies to amend their object clause of the Memorandum of Association by passing a special resolution and requirement of confirmation of Company Law Board was done away with. The amendment Act put a restriction on companies to issue preference shares which are irredeemable or are redeemable after the expiry of a period of twenty years from the date of issue. It allowed the admissibility of micro films, facsimile copies of documents, computer print outs and documents as evidence.

(c) The Companies (Amendment) Act, 1999

As the Companies Bill, 1997 was referred to the Standing Committee it was felt necessary to bring certain amendments immediately, therefore, the Act was further amended by the Companies (Amendment) Ordinance 1998 which was replaced by the Companies (Amendment) Act, 1999 to provide for buy-back of shares, issue of sweat equity shares, Establishment of Investor Education and Protection Fund, Constitution of National Advisory Committee on Accounting Standards and removal of requirement of approval of Central Government for inter-corporate loans and investments.

(d) The Companies (Amendment) Act, 2000

The Companies (Amendment) Act, 2000 aiming at good corporate governance, investor protection and financial disclosures provide for Directors' Responsibility Statement, Audit Committee, Compliance Certificate by a Company Secretary in Practice, Passing of Resolutions by postal ballot, Reduction in number of Directorships, Disqualification of Directors, Reduction in period for payment of dividend, Shelf prospectus, information memorandum, Appointment of Director of Small Shareholders, Minimum Paid-up Capital Requirement for Companies etc.

(e) The Companies (Amendment) Act, 2001

The Companies (Amendment) Act 2001 was enacted to provide, that companies may buy-back its shares upto ten per cent of the total paid-up equity capital and free reserves of the Company without the approval of the shareholders.

(f) The Companies (Amendment) Act, 2002

The Companies (Amendment) Act, 2002 has been enacted with the main objective of facilitating formation of cooperative business as companies and also to convert existing cooperatives into companies. The main objectives of the Amendment Act are :

(i) to offer a statutory and regulatory framework that creates the potential for producer-owned enterprises to compete with other enterprises of a competitive footing;

(ii) to provide for the formation and registration of producer companies which include the mutual assistance and co-operative principles within the more liberal regulatory framework afforded by the Company Law with suitable adaptations.

(iii) conversion of co-operatives to producer companies on purely voluntary basis ;

(iv) the new form of company is designated as "producer company" to indicate that only certain categories of persons can participate in the ownership of such companies. The members of the Producer Company have necessarily to be "primary producers", that is persons engaged in an activity connected with, or relatable to primary produce.

(g) The Companies (Second Amendment) Act, 2002

The Companies (Second Amendment) Act, 2002 provides for setting up of a National Company Law Tribunal having powers and jurisdiction, presently vested with Company Law Board/BIFR or Appellate Authority for Industrial and Financial Reconstruction or High Court. The Amendment Act aims at reducing the entire process which is presently taking several years in winding up of the companies to about two years.

(h) The Companies (Amendment) Bill, 2003

Based on the recommendations of Naresh Chandra Committee on Corporate Audit and Governance, joint parliamentary Committee on Stock Market Scam and R D Joshi Committee on remaining provisions of the Companies Bill, 1997, the Government introduced the Companies (Amendment) Bill, 2003 in the Parliament on

7.5.2003. The major proposals contained in the Bill are:

- Meaning of "Officer who is Default" – list of officers expanded.
- Prohibition of associations and partnership exceeding certain numbers-Professional firms to have upto 50 partners.
- Restrictions on purchase by company, or loans by company for purchase, of its own or its holding company's shares.
- Obligation to reconcile securities with depository.
- Register and index of members and holders of securities to be in electronic form.
- Scope of annual return enlarged.
- Preparation of consolidated accounts.
- Appointment of chief Accounts Officer.
- Disqualifications of auditors.
- Prohibition to provide certain services other than audit.
- Power of Central Government to direct special audit – scope widened to include cost audit and secretarial audit.
- Minimum number of directors increased to seven in certain companies.
- Definition of independent director.
- Retiring age of directors.
- Intercorporate loans and investments through one investment company.
- Power of central Government to direct secretarial audit in certain cases.
- Pre-certification of forms and documents to be filed to be certified by Practising Company secretary

4. REFORMS IN SECURITIES LAWS

The earliest legislation remotely touching the stock market was introduced in 1865 by the Government of Bombay to deal with the situation arising out of the Share Mania of 1860-65. Subsequently, Atlay Stock Exchange Enquiry Committee was appointed in September, 1923 which stressed and emphasised the need for the stock exchange to frame and maintain systematic and settled rules and regulations in the interest of general investing public and the trade. Pursuant to these recommendations, the Government of Bombay offered charter to Bombay Stock Exchange (BSE) in July, 1925 and the Government assumed authority to control the rule making power of the exchange and granted BSE monopoly to organise trading in securities but the exchange turned down the offer. Subsequently, a special legislation namely, Bombay Securities Contracts Act, 1925 for controlling stock exchange came into force w.e.f. January 1, 1926.

Today, the legislative framework dealing with securities markets comprises of Securities Contracts (Regulation) Act, 1956, Depositories Act, 1996 and various regulations and guidelines issued by Securities and Exchange Board of India (SEBI) under the SEBI Act, 1992 including listing agreement of the Stock Exchanges. In the year 2002 the Government amended SEBI Act, 1992 empowering SEBI to inspect listed companies in the case of insider trading or fraudulent and unfair trade practices; to order suspension of trading of security, restrain person from accessing securities market, impound proceeds of securities, attach property etc.; to prohibit any company from issuing prospectus or offer document or advertisement; and to issue cease and desist orders. The amendment Act also enhanced the penalty substantially to rupees one lakh per day upto ceiling of rupees one crore and heavy penalty upto three times of profit or Rs 25 crores in case of insider trading or fraudulent and unfair practices. Amendment Act has made the Securities Appellate Tribunal a three member Tribunal presided over by sitting/retired Supreme Court Judge/Chief Justice of High Court and provides for appeal against the order of SAT only to Supreme Court on question of law.

Securities Laws (Amendment) Bill, 2003

The Government introduced in the Lok Sabha Securities Laws (Amendment) Bill, 2003 to further amend the Securities Contracts (Regulations) Act, 1956 and the Depositories Act, 1996, on August 18, 2003. The Bill is based on the recommendations of the Joint Parliamentary Committee on the Stock Market Scam that the process of corporatisation and demutualisation of exchanges should be expedited.

The amendments to the Securities Contracts (Regulation) Act, 1956 (SCRA), proposed under the Bill include defining the corporatisation and demutualisation; limiting the organisational form of a stock exchange to a corporate entity; specifying the procedure for corporatisation and demutualisation (including approval of scheme for corporatisation and demutualisation by the Securities and Exchange Board of India); specifying the time limit within which the shares shall be disinvested by stock brokers under the scheme of corporatisation and demutualisation; restricting the voting rights of brokers as shareholders, and brokers' participation on governing boards of stock exchanges so as to plug the loopholes inherent in governance of stock exchanges whose organisational form is mutual.

The Bill also proposes to make certain provisions in the SCRA, similar to those contained in the Securities and Exchange Board of India (Amendment) Act, 2002, such as, conferring powers upon the Securities and Exchange Board of India to issue directions to stock exchanges and the companies whose securities are listed or proposed to be listed, providing appeal from the orders of the Securities Appellate Tribunal to the Supreme Court, enhancing the penalties specified under the Securities Contracts (Regulation) Act, 1956, and adjudication by an adjudicating authority to impose monetary penalties, making provision for compounding of offences and crediting of amount of penalties to the Consolidated Fund of India, etc. There is also a proposal to amend the Depositories Act, 1996 to provide for appeals against the orders of the SAT to the Supreme Court on the lines of the SEBI Act, 1992.

5. REFORMS IN FOREIGN EXCHANGE LAW

Immediately after the outburst of the Second World War, Exchange Control was introduced in India on 3rd September, 1939. Control was administered under the emergency powers derived from Defence of India Rules. The emergency powers were later placed on a statutory pedestal through enactment of the Foreign Exchange Regulation Act, 1947 which came into force on 25th March, 1947. The Foreign Exchange Regulation Act, 1973 (FERA) was subsequently enacted to consolidate and amend the law in several respects, encompassing the experience gained over two decades of implementation of control through the earlier enactment of 1947, and considering the report of the Study Group on the question of leakage of foreign exchange through invoice manipulation and the Law Commission report on the Trial and Punishment of Social and Economic offences.

Experience gained over the years in the administration of the Foreign Exchange Regulation Act, 1973 had shown that certain provisions, meant to deal with emergencies of different kinds, are no longer relevant and are required to be removed for improving the climate for foreign investment in India. Hence, the Foreign Exchange Regulation Act, 1973 was reviewed in 1993 and several amendments were enacted as part of the on-going process of economic liberalisation relating to foreign investment and foreign trade for closer interaction with the world economy.

However, in view of the significant developments that have taken place since 1993 such as substantial increase in foreign exchange reserves, growth in foreign trade, rationalisation of tariffs, liberalisation of Indian investments abroad, increased access to external commercial borrowings by Indian corporates and participation of foreign institutional investors in stock markets in India, a Bill to repeal and replace the Foreign Exchange Regulation Act, 1973 was introduced in Lok Sabha on 4th August, 1998. The said Bill was referred to the Standing Committee on Finance, which submitted its report to the Parliament on 23rd December, 1998 with certain modifications and suggestions. After incorporating certain modifications and suggestions of the Standing Committee on Finance, the Central Government introduced the Foreign Exchange Management Bill 1999 in the Parliament to repeal the Foreign Exchange Regulation Act, 1973. The Government notified the Foreign Exchange Management Act (FEMA) w.e.f. June 1, 2000.

There is clearly a departure from the previous Act, i.e. FERA, 1973 as the new legislation contains provisions relating to Current Account Transactions, Capital Account Transactions and determination of residential status on the basis of physical stay in the country. Therefore, it may be said that the present law is an attempt to move from control regime to flexible management approach and regulation by the guidelines issued by the RBI and the Central Government from time to time.

6. REFORMS IN COMPETITION LAW

Legal framework dealing with competition in India spread over various legislations, besides the Monopolies and Restrictive Trade Practices Act, 1969 (MRTP Act) which is the principal legislation dealing with Monopolistic and Unfair Trade Practices since 1969, other legislations include Consumer Protection Act, 1986, Prevention of Food Adulteration Act, 1954, Standards of Weights & Measures Act, 1976, Packaged Commodities Rules, 1977, Patents Act, 1970, the Customs Tariff (Amendment) Act, 1995 and SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 1997.

The principal legislation dealing with competitive activities in India is the MRTP Act 1969. However, with the growing complexity of industrial structure and the need for achieving economies of scale for ensuring higher productivity and competitive advantage in the international market, and a shift in the thrust of the industrial policy to control and regulate the monopolistic, restrictive and unfair trade practices rather than making it necessary for certain undertakings to obtain prior approval of the Central Government for expansion, establishment of new undertakings, merger, amalgamation, take over and appointment of directors, the MRTP Act was amended in 1991 omitting the provisions of sections 20 to 26 and transfer the provisions contained in Chapter III A regarding restrictions on acquisition and transfer of shares to the Companies Act, 1956.

A Committee constituted by the Government of India to examine the provisions of the MRTP Act, in the light of international economic development relating to competition law to suit Indian conditions and to propose a modern competition law suitable to the needs of the country, recommended the repeal of MRTP Act and enactment of new Indian Competition Law and establishment of a Competition Commission of India to implement the new Act and to take up the Monopolistic and Restrictive Trade Practices cases pending before the MRTP Commission. Committee also recommended the abolition of MRTP Commission and suggested transfer of cases of Unfair Trade Practices to the concerned consumer Courts.

Thus based on the recommendations of the Committee and considering the suggestions of trade, industry, professional bodies and the general public, the Government introduced in the Parliament the Competition Bill, with following main objects :

1. to ensure fair competition in India by prohibiting trade practices which cause appreciable adverse effect on competition in markets within India;
2. establishment of a quasi-judicial body to be called the Competition Commission of India undertake competition advocacy for creating awareness and imparting training on competition issues;
3. to curb negative aspects of competition;
4. investigation by the Director-General for the Commission;
5. to empower CCI to levy penalty for contravention of its orders, failure to comply with its directions, making of false statements or omission to furnish material information, etc.
6. to create a fund to be called the Competition Fund;
7. repeal the Monopolies and Restrictive Trade Practices Act, 1969 and the dissolution of the Monopolies and Restrictive Trade Practices Commission.

The Competition Act, 2002 has since been passed by the Parliament to provide, keeping in view of the economic development of the country, for the establishment of a Commission to prevent practices having adverse effect on competition, to promote and sustain competition in markets, to protect the interests of consumers and to ensure freedom of trade carried on by other participants in markets, in India, and for matters connected therewith or incidental thereto. The following provisions of the Competition Act, 2002 have come into effect from March 31, 2003, namely — Short title, extent and commencement (section 1); Definitions of Chairperson [Section 2(d)]; Director General [Section 2(g)]; Member [Section 2(j)]; Notification [Section 2(k)]; Person [Section 2(i)]; Prescribed [Section 2(n)]; Composition of Commission (Section 8); Selection of Chairperson and other members (Section 9); Term of office of Chairperson and other members (section 10); Salary etc. of Chairperson and other members (section 14); Appointment of Director General (Section 16); Registrar and Officers of Commission (Section 17); Power to make rules [Section 63(1) and clauses (a), (b), (d), (e), (f) & (g) of Section 63(2)].

7. SECURITISATION ACT, 2002

The financial sector has been one of the key drivers in India's efforts to achieve success in rapidly developing its economy. While the banking industry in India is progressively complying with the international prudential norms and accounting practices, there are certain areas in which the banking and financial sector do not have a level playing field as compared to other participants in the financial markets in the world. There is no legal provision for facilitating securitisation of financial assets of banks and financial institutions.

Further, unlike international banks, the banks and financial institutions in India do not have power to take possession of securities and sell them. The existing legal framework relating to commercial transactions has not kept pace with the changing commercial practices and financial sector reforms, resulted in slow pace of recovery of defaulting loans and mounting levels of non-performing assets of banks and financial institutions.

The Committees constituted by the Government to examine banking sector reforms have considered the need for changes in the legal system in respect of these areas. These Committees, *inter alia* suggested enactment of a new legislation for securitisation and empowering banks and financial institutions to take possession of the securities and to sell them without the intervention of the court.

Based on these suggestions, the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Ordinance, 2002 was promulgated on 21st June, 2002 the ordinance was later replaced by the Securitisation Act, 2002 to regulate securitisation and reconstruction of financial assets and enforcement of security interest and for connected therewith or incidental thereto. The Act empowers the banks and financial institutions to realise long-term assets, manage problem of liquidity, asset liability mis-matches and improve recovery by exercising powers to take possession of securities, sell them and reduce non-performing assets by adopting measures for recovery or reconstruction.

Salient Features of the Securitisation Act

The salient features of the Act are -

— registration and regulation of securitisation companies or reconstruction companiesby the RBI;

— facilitating securitisation of financial assets of banks and financial institutions with or without the benefit of underlying securities;

— facilitating easy transferability of financial assets by the securitisation company or reconstruction company to acquire financial assets of banks and financial institutions by issue of debentures or bonds or any other security in the nature of a debenture;

— empowering securitisation companies or reconstruction companies to raise funds by issue of security receipts to qualified institutional buyers;

— facilitating reconstruction of financial assets acquired by exercising powers of enforcement of securities or change of management or other powers which are proposed to be conferred on the banks and financial institutions;

— declaration of any securitisation company or reconstruction company registered with the RBI as a public financial institution for the purpose of section 4A of the Companies Act, 1956;

— empowering banks and financial institutions to take possession of securities given for financial assistance-and sell or lease the same or take over management in the event of default, *i.e.* classification of the borrower's account as non-performing asset in accordance with the directions given or under guidelines issued by the Reserve Bank of India from time to time;

— an appeal against the action of any bank or financial institution to the concerned Debts Recovery Tribunal and a second appeal to the Appellate Debts Recovery Tribunal;

— setting up a Central Registry for the purpose of registration of transactions relating to securitisation, assets reconstruction and creation'of security interest.

8. LAWS RELATING TO INTELLECTUAL PROPERTY RIGHTS

Until recently, the law relating to intellectual property in India were contained in Patents Act, 1970, Trade and Merchandise Marks Act, 1958, Copyright Act 1957 and Designs Act 1911.

India being a member of the WTO, is under obligation to give effect to the various provisions of the TRIPs Agreement of WTO. Although, the process of harmonisation of intellectual property law in India with that of international standards have been undergoing for long. Recently, the Government with a view to meet the time frame provided under TRIPs agreement, expedited this process and placed before the Parliament various Bill, either to amend the existing laws, or to enact new legislations.

The Government amended the Patents Act in the year 1995, 1999 and 2002; and the Copyright Act in the year 1994 and 1999. The Government has also enacted following new legislations in the area of Intellectual Property :

1. Trade Marks Act, 1999
2. Designs Act, 2000
3. Semi Conductor Integrated Circuits Layout Design Act, 2000
4. The Protection of Plant Varieties and Farmer Rights Act, 2001.

CONCLUSION

Legal modernisation is required when development in science and industry coupled with policy reforms greatly accelerate the pace of change. Accordingly, the corporate laws reform process was initiated in India to make the legal framework compatible with global standards. A number of legislations have been enacted/ introduced in Parliament and it is hoped that an entirely new regulatory environment conducive to the economic growth of the country will be in place in times to come.

CHANGING BUSINESS SCENARIO AND CORPORATE GOVERNANCE

ARCHANA KAUL*

INTRODUCTION

The rapid scientific technological advancements are reshaping the world. Developments in information and communication technology have revolutionized every activity, be it scientific or business and commerce or individual and personal. For business and commerce, they have facilitated improvements in productivity and bottomline of the business and commerce besides opportunities for better customer service. The productivity improvements come out of the increased speed, accuracy and ability to handle big volumes that technology offers. For the financial sector and banking, the developments in information technology have spelt very special benefits.

In today's globally competitive market, knowledge constantly makes itself obsolete with the result that today's advanced knowledge is tomorrow's ignorance. One has to be on the learning curve and continuously move up. All the knowledge workers have to leverage intellectual capital for growth—creative destruction—keep on innovating— otherwise someone else will be at the top of the pecking order. Companies function in a world of exponentially shortening product and service life cycles where customer preferences and technologies change in a discontinuous and non-linear fashion and business paradigms and rules become obsolete. The future winners will be those business organisations who escape from the gravitational pull of the past on the fuel of innovation.

In the opinion of some experts the twenty first century competition is characterized by at least three fundamental paradigms shifts, viz. -

(a) Ability of organisations and individuals to network globally and seamlessly;

(b) Ability to communicate, transmit, store and retrieve large amounts to information including voice, data, video; and

(c) Mobility of capital to feed good projects around the world.

With the battle for market share and mind-share deepening, companies are increasingly resorting to non-traditional resources (like knowledge) and innovative means (like quick response) to create sustainable competitive advantage.

WHY CORPORATE GOVERNANCE ?

From the beginning corporate governance has acquired connotation of policing the thieves. Major reason for 'confrontationist' undertone is that managers remain unconvinced that corporate governance is a powerful tool for transparent, prudent and participative management that could be fair to all stakeholders and still enhance value of an enterprise as well as reward them commensurate with performance. Consequently, several managers observe corporate governance because it would be difficult to openly object accountability to shareholders, who have risked their capital and responsibility to other stakeholders, whose livelihood depends upon prudent management. Nor can they be seen to grudge the right of stakeholders to get a true picture of business performance and style of management. Perhaps failure in accepting whole-heartedly the spirit of corporate governance is on account of fear of dilution of authority rather than with any predetermined plan for wrongdoing. Realising this inner dilemma of managers and reposing faith in them, the Cadbury Committee, while highlighting unfair managerial practices, opted for voluntary compliance and designed a normative code of conduct. If corporate governance has assumed negative connotation, it is largely due to helplessness on the part of shareholders

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

to deal with corrupt and incompetent managers. Ironically, competitive business environment is bringing the best out of managers as a class. Corporate governance has become a contentions issue because while empowering boards and shareholders to deal with incompetent and corrupt managers is a relatively easy matter, dealing with brutal violation of spirit of corporate governance by 'excellent managers, who have created great shareholder value, is one the biggest challenges.

In the context of fast changing corporate and socio-economic landscapes, fast paced technology and emergence of multilateral trading system, the following factors underscore the need for good corporate governance :

(i) Globalisation, privatisation, deregulation, causing revolution of rising expectations;

(ii) Advancements in Information Technology and E-Commerce.

(iii) Strategic alliances, mergers and acquisitions.

(iv) Intellectual Property Rights.

(v) Social responsibility, social audit and societal concerns.

(vi) Business and professional ethics.

(vii) Sustainable development.

(viii) Energy audit, environmental upgradation.

(ix) Need for excellence to cope up with fierce international competition.

(x) Need to strike a balance between compliance with rules and company's need to perform, so that company's performance is not stifled by over regulation.

DEVELOPMENTS IN BUSINESS SCENARIO

Good governance is a necessary condition for achieving excellence, not a sufficient one. Good governance is a source of competitive advantage and critical to economic progress. Some of the developments which have considerably changed the business scenario in our country which necessitated new approach to governance are :

(a) The New Economic Policy (NEP) of 1991, announced by the Government of India. This is a landmark year in the sphere of economic liberalization and trade related reforms. A number of innovative changes have taken place in the business environment. Major areas of reforms related to abolition of industrial licensing system except for a short list, opening up of Indian economy to foreign investment, liberlisation of norms for foreign technology transfer, abolition of Chapter III of the MRTP Act relating to concentration of economic power, intention of the Government to adopt a new approach to Public Sector Undertakings including disinvestments etc. With these policy re-orientation, the role of the Government, as the regulator has changed from exercising control to one of providing help and guidance by making essential procedures fully transparent and eliminating delays.

(b) Simplification and raitonalisation of both direct and indirect tax laws including lowering of tariff barriers and removal of quantitative restrictions.

(c) Abolition of the office of the Controller of Capital Issues and the setting up of Securities and Exchange Board of India (SEBI), as an autonomous body to promote, regulate and develop the capital market on healthy lines and protection of investor's interests in securities. A number of Rules and Regulations have been issued by SEBI for regulating the activities of intermediaries/others in the capital market.

(d) Replacement of Foreign Exchange Regulations Act, 1973 by Foreign Exchange Management Act, 2000 including introduction of convertibility of rupees on current account.

(e) Liberalization of norms for Foreign Direct Investment (FDI) in Indian Industries and also portfolio investment norms.

(f) Issue of regulations by SEBI regarding SEBI (Prohibition of Insider Trading) Regulations, 1992, SEBI (Prohibition of Fraudulent and Unfair Practices relating to Securities Market) Regulations, 1995 and SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 as amended from time to time.

(g) Setting up of World Trade Organisation (WTO) as an apex body at the international level, to which India is a signatory, to regulate and develop international trade on healthy lines.

(h) Replacement of MRTP Act, 1969 by Competition Act of 2002.

The aforesaid changes and policy re-orientation have ushered in a new era of liberalized business and legal environment. Self-regulation of corporate affairs is now the order of the day.

Another development which should not go unnoticed relates to the perceptible change taking place in India in the profile of corporate ownership, capital market reforms, increasing inflow of foreign capital both on account of Foreign Direct Investment (FDI) and portfolio investment, preferential allotment of shares to the promoters of companies including foreign promoters, the policy of disinvestments being hotly pursued by the Government of India in Public Sector Undertakings (PSUs) – these and other factors are changing the very pattern of corporate ownership. SEBI (Substantial Acquisition of Shares & Takeovers) Regulations, 1997 as amended from time to time and the permission given to the companies to buy-back their shares in the market have also contributed to the changing pattern of corporate ownership.

Globalisation of Indian economy and substantial reduction of tariff barriers-these are pointers to the changing business environment. These factors have given rise to increasing competition in the market place for the Indian products and services. There is an imperative need to manufacture and market high quality products which can withstand the products of foreign manufacturers. The fast changing business environment calls for a new approach to the management of corporate organisations.

CHANGES IN THE COMPANIES ACT, 1956

Establishing norms for corporate governance is not a one time affair. It is indeed an evolving exercise. Therefore, continuous efforts are required to be made to effect changes in the applicable laws so as to improve the standards of corporate governance. Listing agreement was the first document to undergo a change. In this context, it may be pointed out here that SEBI appointed a committee headed by Kumara Manglam Birla to suggest measures for evolving new norms of governance for the corporate organisation. The Committee for a good deal of deliberations recommended certain new norms of governance. SEBI accepted the recommendations of the Committee and directed the Stock Exchanges to implement the same through the listing agreement. At the same time, some changes were introduced in the Companies Act, 1956. The Companies (Amendment) Act, 2000 which came into force with effect from 13.12.2000 brought on the statute book the emerging concepts of the Audit Committee and its role, directors responsibility statement in the directors report, additional disqualifications for directors etc. Introduction of postal ballot for transacting certain items of business in the general meeting was another novel feature of the Amendment Act.

COMPANIES (AMENDMENT) BILL, 2003

With a view to ensure that the definition of independent director as recommended by the Naresh Chandra and Narayana Murthy Committees is given legal sanctity, the Government has proposed to incorporate a new provision in the nature of Section 252A in the Companies Act, 1956. The Companies (Amendment) Bill, 2003 (the Bill), contains clause 119 that intends to define the term 'independent director'. Although in reality, the said clause does not define the term independent director and instead mentions 11 negative attributes or disqualifications which would render a person incapable of being appointed as an independent director. These are more or less on the lines of the recommendations of the two Committees. The proposed section also contains for providing compulsory training to independent directors from such institutions as may be prescribed by the Government.

OBJECTIVE OF GOOD GOVERNANCE

It is felt that the objective of corporate governance i.e., the overall objective of wealth generation and competitiveness for the benefit of all can best be achieved through the twin components of :

— An "inclusive" approach to directors' duties which requires directors to have regard to all the relationships on which the company depends and to the long, as well as the short-term implications of their actions, with a view to achieving company success for the benefit of shareholders as a whole; and

— Wider public accountability: this is to be achieved principally through improved company reporting, which for public and very large private companies will require the publication of a broad operating and financial review which explains the company's performance, strategy and relationships (e.g. with employees, customer and suppliers as well as the wider community).

WHY EXCELLENCE IN CORPORATE GOVERNANCE ?

Business excellence has several connotations. Excellence denotes outstanding performance, superior quality and consistently extraordinary service especially in the face of severe hardships. The word conveys a value-driven approach consisting of respect for humanity, compassion and a positive and proactive attitude towards solving problems while achieving rapid growth.

The future has no shelf life. If today's technology is yesterday's magic, there is an imperative need to be innovative and creative to bring more excellence in vision and mission and products and services. This is a message for Indian corporates and the whole economy of the country, which is going through the phase of churning where centuries old values, structures and practices are giving way to new paradigms comprising new rules of the game. The scenario calls for bench marking of standards of excellence in all spheres of corporate activities, as it has become *sine qua non* for growth and long-term sustainability of companies.

The scenario also calls for excellence in performance which can be achieved only through adherence to good corporate governance principles, such as accountability, transparency, probity, quality of information and by fulfilling their obligations towards society, the nature and the human well being.

Our success in the future will be entirely dependent upon our ability to identify the opportunities, synergies our strengths and skills successfully and turn the challenges into opportunities. This is more important for corporate governance than for any other aspect of the economy. More so, when corporatisation is becoming a way of life with primary, secondary and tertiary sectors increasingly opting for corporate paradigms.

CHALLENGES BEFORE MANAGERS

It would help a great deal if advocates of corporate governance were to appreciate the challenges before managers. The current business environment calls for much stronger leadership and speedier decisions than any time in the past. While globalisation offers new opportunities, it has enormously raised risks and uncertainties. Coping with these has brought CEOs at the center stage and often encouraged centralization of key decisions. Although several managers have built great organisations and rewarded shareholders, many have fallen victim to glorification. Even a cursory study of managerial excellence models would show that these are far less durable than made out by management gurus, keen to produce books. In addition to glorification of individual manager what has aggravated the problem is performance based reward. Financial recognition is indeed an important motivation for managerial excellence but it has gone overboard. At some point in this process the value base of manager has changed and financial compensation emerged as the sole motivator. What has created enormous psychological stress is measurement of 'performance' by investors and securities analysts on the basis of quarterly results. These developments constitute principal explanation of widespread dishonesty as fudging of financials and creative accounting. Seldom can a business create 'shareholder value' quarter after quarter. Excessive risks, expensive and existing mergers, ruthless restructuring (downsizing) have all emerged as measures of managerial excellence and basis of limitless rewards, without, as passage of time has revealed, creating any lasting value for business, stakeholders and society at large. Underlying spirit of corporate governance got destroyed in three ways. One, external checks and balances such as auditors were 'brought in' through bait of lucrative consultancy assignments and independent directors through hefty commissions. Two, if auditors and boards did not fall in line, they were replaced. Financially, if this was not possible, managers found ways of keeping things away from the board and shareholder scrutiny. Managers feeling threatened by increase in shareholder and board power have converted corporate governance into a chor-police game. Like a proverbial Indian politician, many CEOs resorted to unfair means with a single-mined objective of condensing lifetime compensation while in control of business. Overpowered by greed many succumbed to temptation for assumption of massive wealth and securing post-retirement obscene lifestyle without knowledge of the shareholders and not disclosed in the annual reports. Public disclosure of such conduct has shattered the myth that compliance with form of governance is a guarantee of good practice. Myth that professional managers, unlike owner-managers, are not susceptible to frauds is also shattered. The universal response of regulators is to tighten the rules and make them more detailed. Inevitable implication of regulatory tightening is that good managers have to spend more time in compliance than on business issues. More often than not enterprise and innovation as well as risk taking would suffer if corporate governance becomes regulator driven.

CONCLUSION

The forces of globalisation and technology are continuously reshaping the world. According to a recent United Nations Development Report (UNDP), technology is creating the potential to realize in a decade progress that required generations in the past. Corporations across the world are now creating new standards of speed, efficiency and productivity across all sectors.

Corporate governance is proclaimed to be the only global highway for corporate success in the present rapidly changing economic environment. The credibility of the business system, world trade, globalisation and the new emerging economic order depends on good corporate governance. Higher success leads to higher degree of corporate excellence, which is claimed to be foster child of corporate governance. Government has in last two years expedited the process of legal reforms to ensure that a conducive efficient and effective governance mechanism is put in place to allow constituents of reforms process to withstand the convulsions unleashed by the globalisation process, in terms of growing competition and increasing incidence of corporate sickness and insolvency.

Excellence in corporate performance thorough better corporate governance is not a one time goal but it would be an ongoing exercise. There cannot be a full stop on the road to excellence, a company however successful it may be it cannot afford to rest on its laurels, as every day will bring new challenges. Corporates have to be proactive, set a goal for attaining highest standards of corporate excellence.

REFERENCES

1. Souvenir—ICSI National Award for Excellence in Corporate Governance, November 2001.
2. Souvenir—Second ICSI National Award for Excellence in Corporate Governance, December 2002.
3. Chartered Secretary, August 2003.

THE SECURITIES LAWS (AMENDMENT) BILL, 2003 – AN OVERVIEW

V K AGGARWAL* & SONIA BAIJAL**

In view of the recommendations of the Joint Parliamentry Committee on the Stock Market Scam that the process of corporatisation and demutualisation of exchanges should be expedited, the Government introduced in the Lok Sabha Securities Laws (Amendment) Bill, 2003 to further amend the Securities Contracts (Regulations) Act, 1956 and the Depositories Act, 1996, on August 18, 2003.

In order to expedite corportisation and demutualisation of exchanges, the Bill proposes following amendments to the Securities Contracts (Regulation) Act, 1956 (SCRA) :

(a) defining the corporatisation and demutualisation;

(b) limiting the organisational form of a stock exchange to a corporate entity;

(c) specifying the procedure for corporatisation and demutualisation (including approval of scheme for corporatisation and demutualisation by the Securities and Exchange Board of India);

(d) specifying the time limit within which the shares shall be disinvested by stock brokers under the scheme of corporatisation and demutualisation;

(e) restricting the voting rights of brokers as shareholders, and brokers' participation on governing boards of stock exchanges so as to plug the loopholes inherent in governance of stock exchanges whose organisational form is mutual.

Other amendments to the SCRA include amendment of the definition of "securities" to include therein units or any other such instrument issued to the investor under any mutual fund scheme and derivatives based on underlying indices, rates, etc., which themselves are not "securities".

The Bill also proposes to make certain provisions in the SCRA, similar to those contained in the Securities and Exchange Board of India (Amendment) Act, 2002, such as, conferring powers upon the Securities and Exchange Board of India to issue directions to stock exchanges and the companies whose securities are listed or proposed to be listed, providing appeal from the orders of the Securities Appellate Tribunal to the Supreme Court, enhancing the penalties specified under the Securities Contracts (Regulation) Act, 1956, and adjudication by an adjudicating authority to impose monetary penalties, making provision for compounding of offences and crediting of amount of penalties to the Consolidated Fund of India, etc.

The Bill also proposes to amend the Depositories Act, 1996 to provide for appeals against the orders of the Securities Appellate Tribunal to the Supreme Court on the lines of the Securities and Exchange Board of India Act, 1992.

AMENDMENT TO SCRA

Definitions

Corporatisation – The term Corporatisation has been defined to mean the succession of a recognised stock exchange, being a body of individuals or a society registered under the Societies Registration Act, 1860, by another stock exchange, being a company incorporated for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities carried on by such individuals or society.

Demutualisation – The term "demutualisation" has been defined to mean the segregation of ownership and management from the trading rights of the members of a recognised stock exchange in accordance with a scheme approved by the Securities and Exchange Board of India.

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

Derivative – The Bill proposes to define the term derivative as to include :

(i) a security derived from a debt instrument, share, loan, whether secured or unsecured, risk instrument or contract for differences therefor or any other form of security;

(ii) a contract which derives its value from the prices, or index of prices, of underlying securities;

(iii) swap, options and hybrid instruments and other contracts for differences therefor.

Hybrid instruments – The Bill proposes to insert the definition of hybrid instruments, so as to include a depository instrument (being demand deposits or time deposits) or securities (being debt or equity securities) which have one or more components with payment features economically similar to swaps, futures or options.

Scheme – For the purposes of corporatisation and demutualisation, the definition of the term scheme is proposed to be inserted. The term scheme has been defined to mean a scheme for corporatisation or demutualisation of a recognised stock exchange which, may, provide for—

(i) the issue of shares for a lawful consideration and provision of trading rights in lieu of membership cards of the members of a recognised stock exchange;

(ii) the restrictions on voting rights;

(iii) the transfer of property, business, assets, rights, liabilities, recognitions, contracts of the recognised stock exchange, legal proceedings by, or against, the recognised stock exchange, whether in the name of the recognised stock exchange or any trustee or otherwise and any permission given to, or by the recognised stock exchange;

(iv) the transfer of employees of a recognised stock exchange to another recognised stock exchange;

(v) any other matter required for the purpose of, or in connection with, the corporatisation or demutualisation, as the case may be, of the recognised stock exchange.

Stock Exchange – The Bill proposes to amend the definition of the term stock exchange as to mean any body of individuals, whether incorporated or not, constituted before corporatisation and demutualisation under sections 4A and 4B; or a body corporate incorporated under the Companies Act, 1956 whether under a scheme of corporatisation or demutualisation or otherwise,for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities.

Swap - The term swap has been defined to include a contract between the parties providing for the exchange of cash flows based on differences or changes in the value or level of one or more interest rates, currencies, commodities or other assets which may be specified by the Securities and Exchange Board of India.

INSERTION OF NEW SECTIONS 4A AND 4B

Corporatisation and Demutualisation of Stock Exchange

The Bill proposes to insert new section 4A dealing with corporatisation and demutualisation of stock exchanges. This section makes the corporatisation and demutualisation of stock exchanges compulsory. This section provides that on and from the appointed date, all recognised stock exchanges (if not corporatised and demutualised before the appointed date) shall be corporatised and demutualised in accordance with the prescribed procedure contained in section 4B. However, different appointed dates may be provided for different recognised stock exchange. This section empowers SEBI to extend the Appointed date specified in respect of a stock exchange. Appointed date means the date which the Securities and Exchange Board of India may, by notification in the Official Gazette, appoint. The explanation to this section clarifies that if it is satisfied that any recognised stock exchange was prevented by sufficient cause from being corporatised and demutualised on or after the appointed date, SEBI may extend the appointed date specified in respect of that stock exchange and such recognized stock exchange may continue as such before such appointed date.

Procedure for Corporatisation and demutualisation

New section 4B dealing with procedure for corporatisation and demutualisation requires all recognised stock exchanges to submit a scheme for corporatisation and demutualisation for approval of SEBI within such time as may be specified. However, SEBI has been put under obligation to specify by notification in the official gazette the name of the recognised stock exchange, which had already been corporatised and demutualised, as such stock exchange need not submit the scheme.

Sub-section (2) provides that on receipt of the scheme the Securities and Exchange Board of India may, after making such enquiry as may be necessary in this behalf and obtaining such further information, if any, as it may require and if it is satisfied that it would be in the interest of the trade and also in the public interest, approve the scheme with or without modification. However, no scheme shall be approved by the Securities and Exchange Board of India if the issue of shares for a lawful consideration or payment of dividends or provision of trading rights in lieu of membership card of the members of a recognised stock exchange have been proposed out of any reserves or assets of that stock exchange.

Publication of Appproved Scheme

Sub-section (4) dealing with publication of approved scheme require the scheme approved under sub-section (2) to be published immediately by the Securities and Exchange Board of India in the Official Gazette and by the recognised stock exchange in such two daily newspapers circulating in India, as may be specified by the Securities and Exchange Board of India. Upon such publication, notwithstanding anything contained contrary to any other provision of this Act or in any other law for the time being in force or any agreement, award, judgment, decree or other instrument for the time being in force, the scheme shall have effect and be binding on all persons and authorities including all members, creditors, depositors and employees of the recognised stock exchange and on all persons having any contract, right, power, obligation or liability with, against, over, to, or in connection with, the recognised stock exchange or its members.

Rejection of the Scheme

Sub-section (5) provided that where the Securities and Exchange Board of India is satisfied that it would not be in the interest of the trade and also in the public interest to approve the scheme, it may, by an order, reject the scheme and publish the order in the Official Gazette. However, the Securities and Exchange Board of India has been put under obligation to give a reasonable opportunity of being heard to all the persons concerned and the recognised stock exchange concerned before passing an order rejecting the scheme.

Restrictions under the Scheme

Sub-section (6) empowers the Securities and Exchange Board of India to restrict by an order in writing:

(i) the voting rights of the shareholders who are also stock-brokers of the recognised stock exchange;

(ii) the right of shareholders or a stock-broker of the recognised stock exchange to appoint the representatives on the governing board of the stock exchange;

(iii) the maximum number of representatives of the stock broker of the recognised stock exchange to be appointed on the governing board of the stock exchange, which shall not exceed one-fourth of the total strength of the governing board.

Issue of 50% Equity Shares to public

Sub-section (8) requires every recognised stock exchange, in respect of which the scheme for corporatisation or demutualisation has been approved to ensure that at least fifty-one per cent of its equity share capital is held by the Exchange within twelve months from the date of publication of the order, by the public other than shareholders having trading rights. This may be done either by fresh issue of equity shares to the public or in any other manner as may be specified by the regulations made by SEBI.

The SEBI has however, been empowered to extend the said period by another twelve months, on sufficient cause shown by stock exchange and in public interest.

WITHDRAWL OF RECOGNITION (AMENDMENT OF SECTION 5)

The Bill proposes to number the provisions of existing section 5 as sub-section (1) thereof and also proposes to insert new sub-section (2). This new sub-section provides that where the recognised stock exchange has not been corporatised or demutualised or fails to submit the scheme within the specified time or the scheme has been rejected by the Securities and Exchange Board of India, the recognition granted to such stock exchange under section 4, shall, notwithstanding anything contained in the other provisions of this Act, stand withdrawn and the Central Government shall publish, by notification in the Official Gazette, such withdrawal of recognition. However, no such withdrawal shall affect the validity of any contract entered into or made before the date of the notification, and the Securities and Exchange Board of India may, after consultation with the stock exchange, make such provisions as it deems fit in the order rejecting the scheme published in the Official Gazette.

CLEARING CORPORATION

The Bill proposes to insert new section (8A) dealing with clearing corporation. This section entitles a recognised stock exchange with the prior approval of the SEBI to transfer the duties and functions of a clearing house to a clearing corporation for the purpose of—

(i) the periodical settlement of contracts and differences thereunder;

(ii) the delivery of, and payment for, securities;

(iii) any other matter incidental to, or connected with, such transfer.

In this context, every clearing corporation has been put under obligation to make bye laws and submit the same to SEBI for its approval. The Securities and Exchange Board of India may, on being satisfied that it is in the interest of the trade and also in the public interest to transfer the duties and functions of a clearing house to a clearing corporation, grant approval to the bye-laws and approve transfer of the duties and functions of clearing house to a clearing corporation.

POWER TO ISSUE DIRECTIONS

The Bill proposes to insert new section 12A empowering SEBI to issue directions. This section provides that if after making or causing to be made an inquiry, the Securities and Exchange Board of India is satisfied that it is necessary in the interest of investors, or orderly development of securities market; or to prevent the affairs of any recognised stock exchange, or, clearing corporation, or such other agency or person, providing trading or clearing or settlement facility in respect of securities, being conducted in a manner detrimental to the interest of investors or securities market; or to secure the proper management of any such stock exchange or clearing corporation or agency or person, it may issue such directions, to any stock exchange or clearing corporation or agency or person or any person or class of persons associated with the securities market; or to any company whose securities are listed or proposed to be listed in a recognised stock exchange, as may be appropriate in the interests of investors in securities and the securities markets.

EXCLUSION OF SPOT DELIVERY CONTRACTS

The Bill proposes to substitute existing section 18 by the new section. This section provides that subject to the provisions of this section, the provisions of sections 13, 14, 15 and 17 shall apply to spot delivery contracts—

(i) for direct sale or delivery of any security pursuant to a family arrangement entered into amongst the "relative" as defined in clause (41) of section 2 of the Companies Act, 1956;

(ii) for transactions in Government securities entered into in the manner specified, from time to time, by the Reserve Bank of India or the Securities and Exchange Board of India;

(iii) for transactions for sale or delivery of securities in accordance with the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, made under section 30 of the Securities and Exchange Board of India Act, 1992;

(iv) being contracts entered into with the approval of the Central Government, for the purchase or sale of shares of any Government company as defined in section 617 of the Companies Act 1956;

(v) for transactions for sale and delivery of securities, by, or, to a non-resident who has received specific approval under the Foreign Exchange Management Act, 1999 for such sale and delivery of securities from the Central Government or the Reserve Bank of India;

(vi) being contracts entered into by any development or investment agency of the Central or State Government or any international financial agency for financing industrial projects;

(vii) for sale or delivery of securities of a company in terms of pre-emption or similar right contained in the pre-emption or collaboration agreements or in the articles of association of such company or which have been approved by the Central Government or by the Securities and Exchange Board of India;

(viii) for any other transaction or classes of transactions for sale or delivery of securities which may be specified by the Central Government or the Securities and Exchange Board of India from time to time.

The Central Government has, however, been empowered under sub-section (2) to allow by a notification, the application of the provisions of sections 13, 14, 15 and 17 to spot delivery contracts if it is of the opinion that it is necessary to regulate spot delivery contracts in the interest of trade or in the public interest.

DELISTING OF SECURITIES

The Bill proposes to insert new section 21A dealing with delisting of securities. This section provides that recognised stock exchange may delist the securities on any recognised stock exchange if—

(i) the listed company has incurred losses or its net worth has been reduced to less than its paid-up capital; or

(ii) the securities of the listed company have not been continuously traded on a recognised stock exchange; or

(iii) the listed company has failed to comply with the requirements of the listing agreement or provisions of any law for the time being in force; or

(iv) the listed company fails to redress complaints of investors; or

(v) the listed company or its promoters or directors indulge in insider trading or unfair trade practices in securities; or

(vi) the promoter or its directors or persons in management indulge in malpractices including malpractice in dematerialisation of securities in excess of issued securities or delivery of securities which are not listed or for which trading permission has not been given; or

(vii) the addresses of the promoters or directors of a company are not known or addresses of such promoters or directors are false or the company changes its registered office in contravention of the provisions of the Companies Act, 1956; or

(viii) trading in the securities of the company has remained suspended for a period of more than six months; or

(ix) shareholdings of the company held by the public has come below the limit specified in the listing agreement under this Act:

The Bill, however, proposes to empower the Securities and Exchange Board of India to specify, by regulation made by it, any other ground or grounds on which the securities of a company may be delisted. Section 21 further provides that the securities of a company shall not be delisted unless the company concerned has been given a reasonable opportunity of being heard.

Delisting by Recognised Stock Exchange

Sub-section (2) prohibits the delisting of securities on a recognised stock exchange shall be allowed by the recognised stock exchange unless the company, whose securities are listed on such stock exchange obtains prior approval of the holders of securities which are sought to be delisted by a special resolution passed at a general meeting and after giving exit opportunity to the shareholders at a fair price and complying with such conditions, as may be specified by the SEBI or by the recognised stock exchange with the approval of the SEBI.

Appeal against the Decision of Stock Exchanges

Sub-section (3) of section 21 entitles a listed company or an aggrieved investor to file an appeal before the Securities Appellate Tribunal against the decision of the recognised stock exchange delisting the securities, within fifteen days from the date of the decision of the recognised stock exchange delisting the securities.

APPEAL TO SUPREME COURT

The Bill proposes to substitute the existing section 22F by a new section. This new section entitles any person aggrieved by any decision or order of the Securities Appellate Tribunal to file an appeal to the Supreme Court within sixty days from the date of communication of the decision or order of the Securities Appellate Tribunal to him on any question of law arising out of such order. However, the Supreme Court may, if it is satisfied that the applicant was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding sixty days.

INSERTION OF NEW SECTIONS 23A TO 23N

The Bill proposes to insert new sections 23A to 23N dealing with penalty for various offences under the Act, power to adjudicate, factors to be taken into account by adjudicating officer, crediting sum realised by way of penalities to Consolidated Fund of India, appeal to SAT, offences and composition of certain offences. Their description is given below :

(i) Penalty for failure to furnish information, return etc.

Newly inserted section 23A provides that any person, who is required under this Act or any rules made thereunder to furnish any information, document, books, returns or report to a recognised stock exchange, fails to furnish the same within the time specified therefor in the listing agreement or conditions or bye-laws of the recognised stock exchange, shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less; to maintain books of account or records, as per the listing agreement or conditions, or bye-laws of a recognised stock exchange, fails to maintain the same, shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.

(ii) Penalty for failure by any person to enter into arrangement with clients

New section 23B provides that if any person, who is required under this Act or any bye-laws of a recognised stock exchange made thereunder, to enter into an agreement with his client, fails to enter into such agreement, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.

(iii) Penalty for failure to redress investors grievances

New section 23C provides that if any stock broker or sub-broker or a company whose securities are listed or proposed to be listed in a recognised stock exchange after having been called upon by the Securities and Exchange Board of India or a recognised stock exchange in writing, to redress the grievances of the investors, fails to redress the grievances within the time stipulated in the notice or direction of the Securities and Exchange Board of India or a recognised stock exchange, he or it shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.

(iv) Penalty for failure in case of stock brokers

New Section 23D provides that if any person, who is registered under section 12 of the Securities and Exchange Board of India Act, 1992 as a stock broker or sub-broker, fails to segregate securities or moneys of the client or clients or uses the securities or money of a client or clients for self or for any other client, he shall be liable for a penalty not exceeding one crore rupees.

(v) Penalty for failure to comply with provisions of listing agreement or delisting norms

New Section 23E provides that if a company or any person managing collective investment scheme or mutual fund, fails to comply with the listing agreement or delisting norms or commits a breach thereof, it or he shall be liable to a penalty not exceeding twenty-five crore rupees.

(vi) Penalty for excess dematerialisation or delivery of unlisted securities

New Section 23F provides that if any person dematerialises securities more than the issued securities of a company or delivers in the stock exchanges the securities which are not listed in the recognised stock exchange or delivers securities where no trading permission has been given by the recognised stock exchange, he shall be liable to a penalty not exceeding twenty-five crore rupees.

(vii) Penalty for failure to furnish periodical returns etc.

New Section 23G provides that if a recognised stock exchange fails or neglects to furnish periodical returns to the Securities and Exchange Board of India or fails or neglects to make or amend its rules or bye-laws as directed by the Securities and Exchange Board of India or fails to comply with directions issued by the Securities and Exchange Board of India, such recognised stock exchange shall be liable to a penalty which may extend to twenty-five crore rupees.

(viii) Penalty for contravention when no separate penalty has been provided

Section 23H provides that whoever fails to comply with any provision of this Act, the rules or articles or bye-laws or the regulations of the recognised stock exchange or directions issued by the Securities and Exchange Board of India for which no separate penalty has been provided, he shall be liable to a penalty which may extend to one crore rupees.

(ix) Power to adjudicate

Section 23 I dealing with power to adjudicate, empowers the SEBI to appoint any officer, not below the rank of a Division Chief of SEBI, to be an adjudicating officer for holding an inquiry in the prescribed manner after giving any person concerned a reasonable opportunity of being heard for the purpose of imposing any penalty.

The sub-section (2) empowers the adjudicating officer to summon and enforce the attendance of any person acquainted with the facts and circumstances of the case to give evidence or to produce any document, which in the opinion of the adjudicating officer, may be useful for or relevant to the subject-matter of the inquiry and if, on such inquiry, he is satisfied that the person has failed to comply with the provisions of any of the sections 23A to 23H, he may impose such penalty as he thinks fit in accordance with the provisions of any of those sections.

(x) Factors to be taken into account by the adjudicating officer

Section 23J puts the adjudication officer under obligation while adjudging quantum of penalty under section 23-I to take into consideration the following factors, namely:—

(i) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default;

(ii) the amount of loss caused to an investor or group of investors as a result of the default;

(iii) the repetitive nature of the default;

(iv) seriousness of the offence or violation.

(xi) Crediting sum realised by way of penalties to Consolidated Funds of India

Section 23K provides that all sums realised by way of penalties under this Act shall be credited to the Consolidated Fund of India.

(xii) Appeal to Securities Appellate Tribunal

Section 23L dealing with appeals to Securities Appellate Tribunal, entitles any person aggrieved, by the order or decision of the recognised stock exchange or adjudicating officer or any order made by the Securities and Exchange Board of India to make an appeal before the Securities Appellate Tribunal within a period of forty-five days from the date on which a copy of the order or decision is received by the appellant in such form and accompanied by such fee as may be prescribed. However, the Securities Appellate Tribunal has been empowered to entertain an appeal after expiry of the said period of forty-five days if it is satisfied that there was sufficient cause for not filing it within that period. The Securities Appellate Tribunal after giving the parties to the appeal, an opportunity of being heard may pass such orders thereon as it thinks fit, confirming, modifying or setting aside the order appealed against. A copy of the order is required to be sent to the parties to the appeal and to the concerned adjudicating officer. The Securities Appellate Tribunal has been put under obligation to deal with appeal as expeditiously as possible and to make endeavour to dispose of the appeal finally within six months from the date of receipt of the appeal.

(xiii) Offences

Section 23M provides that any person fails to pay the penalty imposed by the adjudicating officer or fails to comply with any of his directions or orders, shall be liable to be punished with imprisonment for a term which shall not be less than one month but which may extend five to ten years, or with fine, which may extend to twenty-five crore rupees, or with both.

(xiv) Composition of certain offences

Section 23N provides that any offence punishable under this Act, not being an offence punishable with imprisonment only, or with imprisonment and also with fine, may either before or after the institution of any proceeding, be compounded by the Securities Appellate Tribunal or court before which such proceedings are pending.

NON-ATTACHMENT OF ASSETS OF INVESTORS

The Bill proposes to insert new section 27B dealing with non attachment of assets of investors provides that an investor may entrust any money belonging to him or his securities in which the investor has right, title or interest, to any intermediary as referred to in section 12 of the SEBI Act, 1992 for the purpose of the same being dealt with or held on behalf of and at the instance of the investor.

The intermediary has been put under obligation to hold such money or securities of the investor as a trustee without right, title or interest of any nature whatsoever therein and deal with such moneys or securities as directed by the investor and be accountable for the same or its proceeds to the investors.

The moneys or securities of the investors, however, will not form part of the assets or trading assets of the intermediaries and no authority shall attach or seize such assets of investors, which are in possession of an intermediary.

RIGHT TO RECEIVE INCOME FROM MUTUAL FUND

New Section 27C makes it lawful for the holder of any securities, being units or other instruments issued by any mutual fund, whose name appears on the books of the mutual fund issuing the said security to receive and retain any income in respect of units or other instruments issued by the mutual fund declared by the mutual fund in respect thereof for any year, notwithstanding that the said security, being units or other instruments issued by the mutual fund, has already been transferred by him for consideration, unless the transferee who claims the income in respect of units or other instruments issued by the mutual fund from the transferor has lodged the security and all other documents relating to the transfer which may be required by the mutual fund with the mutual fund for being registered in his name within fifteen days of the date on which the income in respect of units or other instruments issued by the mutual fund became due.

Explanation to this section clarifies that the period specified shall be extended in case of death of the transferee, by the actual period taken by his legal representative to establish his claim to the income in respect of units or other instrument issued by the mutual fund; in case of loss of the transfer deed by theft or any other cause beyond the control of transferee, by the actual period taken for the replacement thereof; and in case of delay in the lodging of any security, being units or other instruments issued by the mutual fund, and other documents relating to the transfer due to causes connected with the post, by the actual period of the delay.

Sub-section (2) says that the provisions of sub-section (1) shall not affect the right of a mutual fund to pay any income from units or other instruments issued by the mutual fund which has become due to any person whose name is for the time being registered in the books of the mutual fund as the holder of the security being units or other instruments issued by the mutual fund in respect of which the income in respect of units or other instruments issued by mutual fund has become due; or the right of transferee of any security, being units or other instruments issued by the mutual fund, to enforce against the transferor or any other person his rights, if any, in relation to the transfer in any case where the mutual fund has refused to register the transfer of the security being units or other instruments issued by the mutual fund in the name of the transferee.

AMENDMENTS TO DEPOSITORIES ACT, 1996

Appeal to supreme Court

The Bill proposes to substitute the exiting section 23 F of the Depositories Act, 1996 by new section. The new provision says that any person aggrieved by any decision or order of the Securities Appellate Tribunal may file an appeal to the Supreme Court within sixty days from the date of communication of the decision, or order of the Securities Appellate Tribunal to him on any question of law arising out of such order. However, the Supreme Court may, if it is satisfied that the applicant was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding sixty days.

SECURITIES LAWS AND CAPITAL MARKET — CONTEMPORARY DEVELOPMENTS

SONIA BAIJAL*

INTRODUCTION

The studies in capital market have established that there is a direct correlation between the growth and vibrancy of the capital market and economic development of the country. Capital market performs four functions namely, making availabile variety of opportunities to investors to park their disposable wealth; formation of capital both risk capital and debt capital; allocation of capital; and corporate governance.The performance of capital market and SEBI on these four counts has been satisfactory to a large extent, as it has achieved several milestones in making Indian capital market comparable to its counterparts in developed countries. However, the role of SEBI, in the present scenario, as regulator and developer of capital market has become more challenging, in view of fast paced global integration of capital markets.

As far as infrastructure reach, volume of trade and market capitalisation is concerned, the Indian capital market has achieved major transformation parallel to many emerging capital markets. Presently there are 2 National level exchanges (Bombay Stock Exchange – BSE and National Stock Exchange – NSE) and 21 regional exchanges with fully electronic trading platforms and around 9400 broking outfits of which 29 are foreign brokers. The turnover of NSE and BSE in financial year 2001-2002 was around US $ 102 Billion and US $ 62 Billion, respectively. There was negligible trade failure of .003% of the total traded value in financial year 2001 – 02 and at present, more than 90% of the Market capitalization is in the electronic form. There are 38 Mutual Funds with 396 schemes having an asset base of nearly US $21.96 Billion. In terms of regulatory framework there are strict disclosure and accounting norms for the listed companies and facility of book building in public offerings through a transparent price discovery mechanism is also available to the issuers.

SEBI from its very inception, has been continuously endeavouring to make the Indian Capital Market effective, transparent and investor friendly. In this direction, SEBI has undertaken several initiatives of far-reaching consequences which have not only radically reformed but totally transformed Indian Securities Market. Infact SEBI's approach to the regulation has been developmental in nature with a long-term perspective on sustaining confidence of the stakeholders in the market. SEBI is persistently striving to ensure that objectivity and pragmatism is maintained in all its decisions and accordingly, the regulatory process is made extremely transparent and interactive vis-a-vis the stakeholders.

The SEBI has chalked out a vision of becoming the "**Most Dynamic and Respected Regulator-Globally"** and in order to realise the vision, SEBI has drawn a comprehensive Strategic Action Plan aiming at investors, corporates, markets and regulatory regime.

Investors

The strategic Plan envisages that the investors are enabled to make informed investment choices and decisions and achieve fair deals in their financial transactions. In order to implement its strategic plan for investors, Electronic Data Filing and Retrieval System (EDIFAR), an automated web based system for filing, retrieval and dissemination of information pertaining to corporates have been made operational. In the case of debt oriented and balanced funds benchmarking has been made compulsory for providing objective analysis of the performance of the mutual fund schemes. A Code of conduct and Guidelines for Risk Management System for the valuation of unlisted equity shares and due diligence have been issued. Nomination facility for the unit holders has been introduced and Mutual Funds have been advised to follow a uniform method to calculate the sale and

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

repurchase price to avoid confusion in the minds of the investors. Rebating and discounting by the Mutual Funds has also been prohibited for ensuring that all investors get fair treatment.

Markets And Intermediaries

The Strategic Plan envisages that Consumers and other market participants have confidence that markets are efficient, orderly and clean. With a view to achieve this, the exchanges have been directed to follow compulsorily rolling settlement for all listed securities. Inter – depository transfer through on-line connectivity was established between CDSL and NSDL. Straight Through Processing (STP) on the securities market has been made operational. Exchanges have also been directed to establish a comprehensive surveillance mechanism for tracking the derivative markets.

Corporates

The Strategic Action Plan aims that the regulated firms and their senior management understood and meet their regulatory obligations. With a view to ensure due compliance of rules, regulations and guidelines by companies and their senior management personnel Prof. Varma Committee reviewed SEBI (Employee Stock Option Scheme & Employees Stock Purchase Scheme) Guidelines, 1999 to strengthen the same and to remove *glitches*, if any, in the operations of the same. The Committee *inter alia* recommended mandatory disclosure of the fair value of the ESOPs (i.e. using Black Scholes or similar models), the impact on profits and on EPS of the company, had the company expensed the ESOPs on fair value basis and also lock in requirements subject to certain disclosures in the offer documents in case company is going for IPO after the grant of options.

The Accounting Standards Committee has recommended additional disclosures for investment in associate and subsidiaries. It also recommended introduction of half yearly audited consolidated results and quarterly audit review. Credit Rating Agencies have been asked to develop models for rating corporate governance on the principles of wealth creation, wealth management and wealth sharing. A code of conduct has been specified for listed entities for regulated firms under the Insider Trading Regulations.

Regulatory Regime

The Strategic Action Plan aims to achieve an appropriate, proportionate and effective regulatory regime to ensure all the 'stakeholders' confidence.

In this direction, the SEBI Act, 1992 was amended empowering SEBI to check cases of insider trading , fraudulent and unfair trading practices in securities markets and market manipulation in order to protect the investors and to levy deterrent penalties against corporates and individuals in such matters. The SEBI Board was enlarged with the provision of three full time Board members. The Securities Appellate Tribunal was converted into a three member body with a sitting or retired judge of Supreme Court or a sitting or retired Chief Justice of High Court as the presiding officer. With a view to exemplify the saying that charity begins at home, all the orders passed by the Securities Appellate Tribunal and Chairman , SEBI are being posted on the SEBI website, as an effort to enhance regulatory transparency.

Also, with a view to ensure that participation of regulatees as also the nation at large in the process of designing the regulation will improve the efficacy of regulations. SEBI established a consultative mechanism by placing reports of committees and draft regulations on the SEBI website and seeking comments, suggestions and opinions. Besides the involvement of the regulatees in this process, the consultative mechanism has also ensured that the regulates being aware of the changes in the regulatory framework in advance.

As a measure of proactive regulatory approach following regulations and guidelines were amended:

(i) SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 1997

(ii) SEBI (Credit Rating Agencies) Regulations, 1999

(iii) SEBI (Portfolio Managers) Regulations, 1993

(iv) SEBI (Insider Trading) Regulations, 1992

(v) SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002

(vi) SEBI (Foreign Institutional Investors) Regulations, 1995

(vii) SEBI (Issue of Sweat Equity) Regulations, 2002

(viii) SEBI (Underwriters) Regulations 1993

(ix) SEBI (Mutual Fund) Regulations, 1996

(x) SEBI (Disclosure & investor Protection) Guidelines, 2000.

AMENDMENTS TO THE SEBI (DISCLOSURE AND INVESTOR PROTECTION) GUIDELINES, 2000

As mentioned in the preceding paragraphs, the Securities & Exchange Board of India has taken various measures to realize its vision to be the most Dynamic and Respected regulator globally. The amendments to its DIP guidelines is another step to implement its stretagic Action Plan

SEBI, after considering the recommendations of its various Committees and public comments thereon, has approved certain modifications to be incorporated in the Guidelines and accordingly, under the provision of Section 11(1) of SEBI Act issued the amendments to SEBI (DIP) Guidelines, 2000.The amendments are applicable to all public issues/ rights issues/offer for sale and come into effect immediately.The major highlights of the amendments made are as under:

(i) Review of Eligibility Norms

The purpose of review of existing eligibility norms of the issuers is to strengthen the existing norms, to facilitate entry of mid-cap, small-cap new entrepreneurs to the primary market without exposing the public to undue risk, to maintain quality of issuer companies and also to keep fly by night issuers at bay. Accordingly, amendments to SEBI(DIP) Guidelines include introduction of Net Tangible Assets and minimum number of allottees as additional criterion, appraisal route as an alternative to the mandatory book building route etc.

(ii) Review of Book Building guidelines

With a view to make price discovery process more realistic, immune from artificial demand and more responsive to the market demand, SEBI has been reviewing the existing book building guidelines on an ongoing basis. The amendment provides companies a flexibility of indicating a movable price band or a fixed floor price in Red Herring prospectus, definition of Qualified Institutional Buyers has been enlarged to include Insurance companies, Provident and Pension funds with minimum corpus of Rs. 25 crores. Further operational guidelines are amended thus shortening the interregnum between the closure of issue and listing/ trading of securities to T+6 (T stands for date of closure of issue). Setting up of price band will assist the retail participants in placing their bids and would Act as a good guidance for the retail investor in placing the bids. Also the stipulation to list book built issues within 6 days instead of earlier 15 days of the closure of the issue will benefit the investors in two ways. Firstly, there will be no artificial market between the issue closing date and date of listing and secondly investors money will not remain locked in for a longer period of time.

(iii) Introduction of Green Shoe Option

Green Shoe option denotes an option of allocating shares in excess of the shares included in the public issue. Green Shoe option is extensively used in international IPOs as stabilization tool for post listing price of the newly issued shares. It has been introduced in the Indian Capital Market in the initial public offerings using book building method. SEBI has introduced this option with a view to boost investors' confidence by arresting the speculative forces which work immediately after the listing and thus results in short-term volatility in post listing price. Green shoe option would definitely ensure price stability, so that visual volatility in first few days of listing is curbed.

(iv) Review of Disclosure Requirements in the Offer Documents

SEBI has been reviewing the existing disclosure requirements in the offer documents on an ongoing basis .The amendments to disclosure requirements in the offer document *inter alia* include full disclosure about the promoters including their photograph, PAN number etc, classification of risk factors, use of standard financial units etc.

(v) Review of Requirements Pertaining to Issue of Debt Instruments

SEBI has reviewed the role of debenture trustees and also the provisions pertaining to issue of debt instruments in SEBI (DIP) guidelines 2000. Accordingly, the amendments to requirements in relation to debt instruments *inter alia* include prohibition on a willful defaulter to make a debt issue, requirement of investment grade credit rating for making a debt issue, relaxation in the existing provisions of promoters contribution in IPO of debt issue etc.

(vi) Modifications Related to Employee Stock Option and Employee Stock Purchase Scheme

In accordance with amendments effected in SEBI (Employee Stock Option Scheme & Employee Stock Purchase Scheme) Guidelines, 1999 on June 30, 2003, SEBI (DIP) Guidelines, 2000 have been amended providing for relaxation in the provisions of lock-in for the pre-IPO shares held by employees, which were issued under employee stock option or employee stock purchase scheme of the issuer company before the IPO and inclusion of provision of existing clauses of SEBI (ESOP & ESPS) guidelines in SEBI (DIP) Guidelines, 2000.

(vii) Designated Stock Exchange

SEBI (DIP) Guidelines, 2000 also include amendments to give effect to Ministry of Finance (MOF) circular dated April 23, 2003, thereby withdrawing the concept of regional stock exchange.

Accordingly, the companies have been given flexibility to choose a Stock Exchange defined as a Designated Stock Exchange in the guidelines for a particular issue made under these guidelines and for subsequent issues also, the companies have freedom to choose some other stock Exchange as a Designated Stock Exchange.

(viii) Review of Operational/Procedural Requirements

With a view to streamline Operational and Procedural Requirements, Amendments to SEBI (DIP) Guidelines, 2000 *inter alia* include reducing the validity period of SEBI's observation letter to 6 months from 365 days, demarking the responsibilities of lead managers, defining associate etc.

Amendments to the SEBI (Disclosure And Investor Protection) Guidelines,2000 and other Regulations are a welcome step towards investor Protection and restoring the confidence of investors in the capital market. However the present system of due diligence by an eligible merchant banker needs a relook. Therefore, it is suggested that the due diligence and certification that all norms laid down by SEBI has been complied with should be issued by the panel constituted by SEBI which should consist of independent professionals like Practising Company Secretaries. The carrying out of the due diligence by an independent agency would definitely provide a level playing field to the professionals. Thus independent professionals be entrusted to perform the due diligence and certify that all norms prescribed by SEBI have been complied with.

The existing disclosure requirements under SEBI (Disclosure & Investor Protection) Guidelines, 2000 are quite exhaustive and give an insight to the investor in the affairs of the company. However, there are few areas/points which need to be disclosed in the prospectus/letter of offer in addition to the present disclosures. Also various companies while making disclosures adopt divergent practices in the absence of standardised formats in the guidelines. Therefore, there is a need to provide comprehensive formats incorporating the requisite details asked for in the guidelines in order to upgrade the quality of disclosures made, in prospectus/letter of offer. The standardised formats, if introduced as part of SEBI (Disclosure & Investor Protection) Guidelines, 2000 would definitely prove to be a benchmark for disclosure of information and would provide more inputs to the investors/analysts.

INNOVATIONS IN THE SECURITIES MARKET

With a view to ensure that markets remain innovative in meeting the interests of all stakeholders and in furtherance of its consultative process, SEBI prepared and issued for public comments, a Discussion Paper on Innovations in the Securities Market, containing trading of rights on stock exchanges in electronic form; Strategic use of put options in the fixed price buy back and takeover cases; Buy-back of shares for other than the cash; Insurance and trading of third party warrants; put options and event risk in bonds; and professional rating of the intermediaries. The description of concepts and proposals is explained in foregoing paragraphs.

Trading of rights on the stock exchanges in electronic mode

The rights issue is a concept which offers to the existing shareholders of the company a right to buy the additional shares at the given terms. These rights offer just the right to the investors to buy shares and create no obligations on their part. It essentially mean that these rights are nothing but the call options on the issuer's stock to the existing shareholders of the company. Presently, these rights are offered to the investors in the physical form and traded in the Over the Counter Market (OTC). Trading of the rights in OTC is suffering from issues like poor liquidity, lack of price discovery and movement of physical papers, the SEBI discussion paper proposes the issue of rights in the electronic form by crediting the demat account of the investors, and to be listed and traded on the stock exchanges for the limited period of their life, in the Capital Market Segment for the same T+2 rolling settlement, a separate ISIN may be assigned to the rights.

The proposal envisages that these rights may also be issued in the physical form, if desired by the investors. However, trading on the exchanges would essentially be in the electronic form mode. Although the shareholders would continue to always have the right to apply for the additional shares, but the same would be allotted shares only if some rights don't get exercised.

Unlike the present position in which renouncing the rights or sharing the right among three-four people becomes difficult, the electronic form enables these rights to be freely transferable from one account to another account and thus investors would be able to renounce/ split the rights as per their will. Hence, the trading of rights in electronic form would provide tremendous flexibility. Additionally, reduction in work would result in saving enormous administrative costs at the end of investors and companies.

It is believed that trading of rights on the stock exchanges would add values to the investors in terms of better liquidity, price discovery, cost saving and convenience. Trading on the exchange would facilitate even the intra day trading in these rights, which would make the market in the instrument very exuberant.

Put warrants Approach to the Fixed Price Buy Back/Takeover Offers

The concept of Buy back of shares by the listed companies which was introduced in the Indian Capital Market in 1998, have been utilized by various companies since its inception. SEBI Buy Back Regulations allow companies to buy back their shares through the fixed price tender offer on proportionate basis; or book building route; or open market purchase.

As per the existing methods, in case of fixed price tender offer, the purchase price per share is fixed by the company and is disclosed to the investors as the takeover regulations also provide for the fixed price tender offers i.e. an acquirer can invite investors to offer their shares to the acquirer at the pre-determined fixed price, Indian Capital Market has witnessed large number of fixed price takeover cases. While, in the book building case, it is determined through free interaction of demand and supply forces and in the open market purchase, purchase price is the market price of the share and varies from transaction to transaction.

The Discussion Paper proposes that the companies coming out with the fixed price buy back/tender offers, issue the put warrants to the investors on proportionate basis. It may be clarified that put warrants are essentially the put options which offer the right to the investors to sell their shares to the company acquirer at a specific price. As there is a specific price on the put option, it can be a perfect substitute to the fixed price offers, however, the operational mechanism of the new and innovative instrument would be different and would offer host of advantages to the investors, issuers and market.

While explaining other issues the discussion paper suggests that in case promoters don't intend to participate in the buy back process, issuance of the put warrants to the investors can be increased accordingly. Similarly, in case of the takeovers, to the extent of the equity stake with the acquirers, the issuance of the put warrants to the investors would increase. Further, investors may always be allowed to apply for the shares without the put warrants but those shares would be accepted only when some investors don't exercise their rights. This acceptance of the additional shares would take place on proportionate basis. Further, in case of takeover cases, there is always a possibility of competitive bids. In such cases, the warrants issued by the competitive bidders would be recognized by the separate ISINs and listed and traded in the market. Additionally, with a view to avoid the withdrawal by the bidders they would be required to take all the necessary statutory approvals in advance.

The discussion paper works on the assumption that companies have two sets of investors – investors with depository account and investors with shares in physical form. The company may directly credit the warrants in their depository accounts of investors with demat account and inform them along with letter of offer. For investors holding the shares in physical form, warrants may be dispatched along with the letter of offer. The demat account holder while tendering the shares, may directly transfer the shares along with the required number of put options to the demat account opened by the company for the buy back purpose and physical documents may be sent to the Merchant Banker/registrar of the company. However, the company has to list the warrants on stock exchange which will be the additional cost to the company.

Buyback of Shares for Other than the Cash

The regulations allow buy back of shares by the companies only for the cash. The Buy back regulations also allow the companies to raise the funds through the securities other than the shares for the specific purpose of buy back of its own shares. In other words, the company may raise the funds through a debt instrument for paying for the equity, planned to be bought back.

In the existing regulatory environment a possibility cannot be ruled out that some existing shareholders subscribe to the debt offer of the company, made to raise funds to meet the buy back outflow. The company would thus use the same funds for buying the equity back from the said investors. Therefore, the investors, who subscribed to the debt offer of the company would be given the cash back for their equity, thereby resulting in the two cycles of cash movement. This situation of two cycles of cash movement can be squeezed to one by allowing the buyback of shares for other than the cash. The discussion paper explains this concept as to mean the company could offer the debt instrument to the said investor instead of first receiving the cash and then paying it back. This instrument to instrument transaction could save enormous administrative hassles and financial loss to both the investors and issuers.

In this context, situation may arise when all the equity holders may not be interested in the debt instrument.

This instrument may be helpful for the capital restructuring, where it makes enormous sense for the companies to go for exchange of instruments i.e. company may like to replace the equity with the debt or any other instruments. Therefore, allowing companies to buyback for other than the cash would pave the way for enormous creativity in the system.

Here, it is pertinent to note that acquisition of the shares in Takeover cases is allowed for other than the cash. In fact, this is being practiced globally at a large scale as a corporate restructuring exercise.

Issuance and trading of third party warrants

A warrant is basically an option, therefore, a warrant can be a call warrant or a put warrant. Call warrants offer the right to buy the underlying asset and put warrants offer the right to sell the underlying asset. In the cash market, lots of companies have issued the warrants. These warrants have been issued as sweeteners with the other products like bonds or equity. These warrants are generally call warrants, providing a right to the warrant holders to exercise their warrants to secure a specific number of equity shares at a specific price within a specified time period.

These warrants are generally detachable and are exercisable in cash, by investors. Detachable essentially means that they can be stripped from the instrument they are issued with and then traded separately on the stock exchanges. Further, these call warrants generate money for the investors only if the market price of share, at the time of exercise of warrants, is more than the strike/exercise price plus cost of acquiring these warrants.

The issuance of a covered warrant is, basically, a variant of the covered call strategy which involves the writing of call options backed by the underlying shares. In the same way, a covered warrant is a call option written by an entity backed by the underlying shares. This warrant is separately listed and traded on the stock exchanges. Like any other equity linked instrument, it may represent the specific number of underlying shares i.e. this option/warrant may be linked to any number of underlying shares. However, unlike vanilla call warrants, covered warrants are issued by a third party, holding large portfolios.

The question however arises as to why there is need for covered warrants when exchange traded options are available and the institutions can anyway do the covered call there on the bourses? The discussion explains that yes, the institutions can do the covered calls in the listed options but the choice for the same is limited.

The justification given for this instrument is that the exchange traded options are rigid in many senses and don't offer the flexibility, which is required by the institutions. The covered warrants offer the tremendous flexibility to the issuers in designing the option instrument. Different traches with different features like different strike prices, different maturities and different kinds of options (American, European, Bermuda etc….) can be architected. This flexibility to the issuers has opened an entirely different set of opportunities for the market participants through the covered warrants. The spectacular and unprecedented growth in the covered warrants over the last couple of years, across the globe, bears testimony to it.

Further, it should be noted that as long as the price of the underlying assets in the cash market is lower than the strike price, call option would not be exercised. So, if at the time of issuance of the covered warrant, the strike price of option was higher than the cash market price (stock pick price), all the profits till the strike price would go to the institution.

Put options and event risk in the Bonds

Conflict of interest between the debt and equity holders in a company has always been debatable. Companies keep on harping about enhancing the value of the equity holders. Rarely, attention is given to the interest of the debt holders, who are equally important to the company. Interests of the debt holders is ignored more when they are small individuals and scattered across the country.

Many a times, actions of the company, rewarding equity holders, result in the value loss to the bond holders. For instance, when company is paying hefty dividend to the equity holders or buying the shares back at very high premium to the market price, value of the company goes down as cash goes down. These actions of the companies also change their debt/ equity ratios, sometimes drastically. Generally, bond holders are not the part of these decisions and are not compensated in any way for the extra credit risk they bear in the new higher leveraged company (company with higher debt/ equity ratio). In other words, though the interest of debt holders is at stake in these decisions of the company, they are rarely the part of them. This phenomenon is called as the bondholders' expropriation as the equity holders enjoy the disproportionate values at the cost of the debt holders. Risks generated by these events are termed as the event risks to the debt holders. Another instance of the event risk is the deterioration in the credit rating of a company. This enhances the credit risk (risk of default) to the bond holders without any compensating provision. These events reduce the market prices of the bonds.

Sometimes, bond covenants (indentures) do mention certain instances when the permission from the bond holders is required before company finalizes the decisions, affecting their interest. But, all the possible scenarios may not be captured in the bond covenants. Further, as bond holders themselves are the best judge of their interests depending on their individual perception of the events affecting the issuer, better solution to their interest's protection would be the availability of put option to them.

A put option is an option to sell the underlying asset at some future date at a specific price called the strike price. Buyer of the put option has the right but no obligation with regard to the sell. On the other hand, seller of the put option has the obligation (to buy the underlying asset from the buyer of the option), and no right in the contract. In other words, if the buyer of the put option wants to exercise his right seller has no choice but to honour the obligation. Further, these options are said to be embedded in the bonds because they cannot be detached and traded separately in the market.

Terms of their exercise are defined in the offer document. Investors, generally, exercise their put options when they want exit at a time while the market price of bonds is lesser than the put strike price. These options, sometimes, are allowed to be exercised only after a specific period of time from the date of issue. This period when the option can not be exercised is called the lock in period.

Availability of put option to bond holders enable them to put the bond back to the company and take money in any event, if investors think that their interest is being jeopardized. These options become more valuable to bond holders when liquidity in the system is low and buyer, in case of deterioration of quality of paper, is either not available or available at a very deep discount. Therefore, in the markets like India where the trading in the corporate debt is very thin and the risk of instrument turning junk is high amidst these event risks and absence of good liquidity, these put options do make tremendous sense.

These put options in bonds emerged as the instrument to protect the investors against the interest rate risk i.e. allow them to sell the bond back to the issuer at a predetermined price in case of price fall because of rise in the general interest rates in the economy. But, over the period of time, their use has been expanded to manage the event risks. Today, when interest rate risk is better managed through the floating rate instruments, put options are primary instrument for event risk management.

In the developed markets like U.S., embedded put options in bonds are extensively used as a protective mechanism against the event risks. Indeed, many a times, there are special provisions in the bond covenants with regard to these events and these options are exercisable by investors even during the lock in period. In India, some bonds issued by ICICI and IDBI do have put option provisions.

Therefore, there is need to encourage bond holders to become more demanding and ask for the put option along with the bonds. Debenture Trustees may play a crucial role here. These options would offer investors with tremendous flexibility with regard to protection of their interest. They would also encourage the discipline on the part of the company, while taking the decision, which may result in the bond-holder's expropriation.

SEBI CORPORATE GOVERNANCE INITIATIVES – A REPORT CARD

The eminent economic need of the countries is higher ethical standards, standards enforced by strict laws and upheld by responsible business leaders. Therefore, the strict enforcement and higher ethical standard are imperative to usher in a new era of integrity in corporate sector not only in India but across the countries. The country needs the confidence in the character and conduct of all captains of business because the faith in the fundamental integrity of business leaders is being undetermined. There is recurrence of fraud and scandal.

The lure of heady profits of the late 1990s spawned abuses and excesses. There have been instances when business leaders are found obstructing justice and misleading clients, falsifying records, business executives broaching the trust and abusing power. It is not that all business people are dishonest. The vast majority of businessmen are honest. They do not cut ethical corners and they are wealth creators not the wealth destroyers. Yet high profile acts of deception, irregularities and manipulations have shaken people's trust. These scandals have hurt reputations of many well governed companies. They have damanged the reputation of stock markets and shattered the trust of millions of investors.

US President George W Bush while addressing on corporate misconduct in the aftermath of Enron debacle on July 9, 2002 said that "Self regulation is important, but it's not enough. Government cannot remove risk from investment or change for the market. but Government can do more to promote transparency and ensure that risks are honest. And Government can ensure that those who breach the trust of the American people are punished."

Tougher laws and stricter requirements will help, improve the good corporate governance. Yet ultimately, the ethics of corporate India depends on the conscience of captains of industry and business leaders. There is need for character building and attitudinal change to be able to differentiate between ambition and destructive greed, between justified risks and irresponsibility between enterprise and fraud.

Hence, the Sarbanes Oxley Act was enacted to provide for tougher penalties, enhacing the imprisonment for those convicted for financial fraud, and streamlining corporate accounting and reporting to give investing public a true, fair and timely picture of assets and liabilities and income of publicly traded companies. The Sarbanes Oxley Act ineed has ushered in a new era of good corporate governance and benchmarked the standards thereof. The Enron debacle and consequent enactment of Sarbanes Oxley Act has left its impressions on national Governments and regulatory authorities the worldover and annexed a new Chapter in the initiatives for good corporate governance.

In India, also committees were set up to look into existing norms for good corporate governance. The Department of Company Affairs constituted a Committee headed by Shri Naresh Chandra to look into Auditor Company relationship and SEBI set up a Committee headed by Shri N R NarayanMurthy to look into existing corporate governance norms as enshrined in clause 49 of the Listing Agreement included on the basis of SEBI Committee on Corporate Governance headed by Shri Kumar Mangalam Birla. Both these committees have submitted their report. However, for the purpose of present discussion, major recommendations of Shri N R Narayan Murthy Committee are elaborated.

The issues discussed by the Committee primarily related to audit committees, audit reports, independent directors, related parties, risk management, directorships and director compensation, codes of conduct and financial disclosures. The key mandatory recommendations focus on strengthening the responsibilities of audit committees; improving the quality of financial disclosures, including those related to related party transactions and proceeds from initial public offerings; requiring corporate executive boards to assess and disclose business risks in the annual reports of companies; introducing responsibilities on boards to adopt formal codes of conduct; the position of nominee directors; and stock holder approval and improved disclosures relating to compensation paid to non-executive directors.

Non-mandatory recommendations include moving to a regime where corporate financial statements are not qualified; instituting a system of training of board members; and the evaluation of performance of board members.

The Committee observed that these recommendations codify certain standards of "good' governance into specific requirements, since certain corporate responsibilities are too important to be left to loose concepts of fiduciary responsibility. When implemented through SEBI's regulatory framework, they will strengthen existing governance practices and also provide a strong incentive to avoid corporate failures. On the question as to whether the costs of governance reforms are too high,it should be noted that the failure to implement good governance procedures has a cost beyond mere regulatory problems. Companies that do not employ meaningful governance procedures will have to pay a significant risk premium when competing for scarce capital in today's public markets.

The Committee recommended that it should be mandatory for companies to affirm that they have not denied any personal access to the audit Committee and that they have provided protection to whistle blowers from unfair termination and other unfair or prejudical employment practices.It is a welcome recommendation. However, it may be suggested that the whistle blower policy should be in writing to prevent it from becoming a mere ritual. Companies should formulate a whistle blower policy and the same shall be incorporated appropriately in employment rules of the company. It is preferable if it is separate policy in writing on lines of policy of Insider Trading etc. of many companies now-a-days.

The Committee in its mandatory recommendations, required the Audit Committees of publicly listed companies to review, reports relating to compliance with laws and to risk management. However, the committee has also recommended that management should place a report before the entire Board of Directors every quarter documenting the business risks faced by the company, measures to address and minimize such risks, and any limitations to the risk taking capacity of the corporation. This document (report) should be formally approved by the Board. To bring uniformity in the above two recommendations, it is suggested that Management should place the report before Audit Committee every quarter for detailed discussion and analysis and the Audit Committee should then be responsible to place its review of the same before Board Meeting every six months. It is additionally suggested that a sub-committee may be formed by the Audit Committee for review of risk management as envisaged.

Regarding the reports relating to compliance with laws and risk management, formats may be prescribed requiring certification by an Independent professional having expertise in the field. Risk Management report format should include locational risks, activity risks, political risks and other business related risks etc.

The Committee recommended that minutes of the Board meetings of the subsidiary company should be placed for review at the board meeting of the parent company. In this context, it may be pointed out that it is practically not feasible to review the minutes of each Board meeting of subsidiary company at the Board Meeting of parent company, therefore, it is suggested that this recommendation should be restricted to circulation of the minutes of subsidiary company along with the agenda of the Board Meeting of parent company and should be noted at the Board Meeting.

One of the non mandatory recommendation of the Committee says that the companies should be encouraged to move towards a regime of unqualified financial statements. Hence, it may be suggested that though Companies may be encouraged to slowly move towards a regime of unqualified financial statements, to maintain transparency, the auditors should, in such a case, indicate by way of a note, the qualifications, if any, which they had observed and which have been cured by the company.

The Committee recommended that audit Committee should comprise of non executive directors. It does not augur well to have only non executive directors as members of the audit Committee because handing over the review of entire financial matters in the hands of non-executive directors, without any representation of executive management, may not be in the interest of the company. Atleast one member should be a director representing management's view point. Therefore, it is suggested that the audit committee should also comprise of atleast one executive director besides non-executive directors.

OMBUDSMAN – A STEP TOWARDS BETTER CORPORATE GOVERNANCE

Ombudsman—The Concept

The expression "Ombudsman" is of Scandinavian origin and denotes the mediator, the advocate. As a scheme, it aims to supervise public administration, fight bureaucracy, increase openness and generally offer citizens extra-juridicial protection. The Ombudsman scheme is very old and well recognised. The origin of Ombudsman is as far back as Ancient Greek times. The Ombudsman scheme was first constitutionally introduced in Sweden in 1809 and is nowadays established both in the Public Sector and in various private sectors.

The essential characteristics of an Ombudsman Office are independence, the ability to investigate complaints, which often includes the ability to criticize government agencies and to recommend changes that may be issued in public reports. An Ombudsman however, has no enforcement or disciplinary powers. Independence in relation to the Ombudsman means that he must be free from interference in the legitimate performance of duties. Ombudsmen are independent so they can be impartial. Their findings and decisions are based on examination and analysis of the facts and law. They must avoid even the appearance of serving the interests of the organizations they investigate and must not appear to serve the agenda of legislative or government leaders. That independence creates credibility for the Office among citizens, particularly those who file complaints.

The Ombudsman Office is a paradox, being both powerful and powerless at the same time. It can investigate complaints, choosing which are the most important and initiate investigations without complaints. It can determine whether a complaint is justified and seek remedies for it. It can compel people to produce records. It cannot, however, force an agency into action, but it can make its reports public. Confidentiality is important for creating an environment where citizens and government agents can feel comfortable confiding in the Ombudsman. These confidentiality measures protect both complainants and the subjects of complaints. Therefore, citizens and government agents can feel comfortable that their communications with the Ombudsman will remain confidential.

The Ombudsman has the ability to help deter lawsuits, in part, because the Ombudsman serves as an active listener who cares about the problem and whose charge is to resolve it. By lending an ear, and providing information and an informal grievance mechanism for resolving complaints, the Ombudsman prevents innumerable unnecessary and costly lawsuits involving the government.

Ombudsman for Securities Market

The Joint Parliamentary Committee in its Report on Stock Market Scam and Matters Relating Thereto recommended that – "14.60 – There also appears to be a need to have an independent look at resolution of investor complaints against companies and market intermediaries. The Committee recommended that the concept of Ombudsman, which is already being used in the Banking Sector, should also be extended to the capital market. The issue of power, duties and responsibilities of the Ombudsman should be suitably worked out. As regards investors complaint against broker and other market intermediaries, Arbitration Councils at exchange level can be used for resolution of investors complaints. Such body would be independent of market intermediaries, particularly the brokers … .."

Keeping in view the recommendations of the Joint Parliamentary Committee and to provide an informal, expeditious, cost effective and efficient alternative redressal mechanism, SEBI introduced the concept of Ombudsman for redressal of grievances of investors in securities against the listed companies and the intermediaries in the securities market relating to refund of money or securities amount or any claim in respect of dealing in securities or deficiency in services by intermediary and other related matters. Ombudsman for securities market may be established with the statutory status since SEBI has powers under the SEBI Act to protect the interests of the investors and the matters connected with the securities market by such measures as it may think fit.

The proposal of Ombudsman for Securities Market was discussed in the meetings of the Legal Advisory Committee of the Securities & Exchange Board of India, headed by Mr. Justice M. N. Venkatachaliah, Former Chief Justice of India. The Committee has suggested the framing of the SEBI (Ombudsman) Regulations by SEBI pursuant to its functions under section 11 of the Securities and Exchange Board of India, Act, 1992. In accordance with the suggestions of the Committee, SEBI prepared a draft of the SEBI (Ombudsman) Regulations, 2003 and issued for Public Comments as part of its consultative process.

Salient Features of the Ombudsman Regulations

Appointment of Ombudsman

Regulation 3 deals with Appointment of Ombudsman and empowers the Chairman, SEBI to appoint the same initially at the Headquarters on the recommendation of a Selection Committee consisting of three members namely a retired High Court Judge, an expert of financial market and an Officer of SEBI not below the rank of Executive Director, depending on the number of the complaints in a particular area. The Ombudsman so appointed may utilize the infrastructure available at the Regional Offices of SEBI or the local stock exchanges.

It is suggested that even in the initial stages the Ombudsman should be appointed at least at all the Metropolitan Cities.

With a view to make the concept easily accesible to investors, inexpensive, quick and informal, it is proposed that the Stipendiary Ombudsman may be appointed by the Chairman, SEBI on requisition by SEBI or the Ombudsman for a number of cases in specific areas depending upon the number of complaints received. The Stipendiary Ombudsman has been empowered to exercise all powers and functions as are vested in the office of the Ombudsman. The Regulations further provides that the Stipendiary Ombudsman shall be paid such fees and allowances for the services rendered by him as may be determined by the Board from time to time and such fees shall be honorary fees or sitting fees.

Qualification, Tenure etc. of Ombudsman

Regulation 5 deals with qualification, Tenure etc. of ombudsman and providing that the person of high moral integrity having atleast 40 years of age, having atleast 10 years experience of service in any regulatory body or having special knowledge and experience in law, finance, economics, management and administration or either a retired District Judge, are qualified to be appointed as an Ombudsman. In the case of Stipendiary Ombudsman regulation 9 stipulates that the person to be appointed as Stipendiary Ombudsman has to be a person of good social standing having served as a judicial or executive officer or having experience of atleast 10 years in matters relating to consumer or investor protection or having legal practice or served for a minimum period of 10 years in any financial institution or a regulatory body.

Here, it may be pointed out that the different qualifications for the appointment of both ombudsman and stipendiary ombudsman have been specified keeping in view distinct status. The Ombudsman has to be established as a permanent authority with monthly salary and has to deal with the matters on continuous basis. The stipendiary Ombudsman shall be appointed for the specific disputes and may be paid sitting fees depending upon the nature of the complaints.

Remuneration

Regulation 8 provides that the salary and allowances payable to ombudsman shall be determined by SEBI from time to time. The regulation 11 further provides that the cost and expenses of ombudsman shall be shared by the listed company and the intermediaries in such proportion and in such manner as may be determined by the Board from time to time.

Here it may be noted that as per circular SE/10118 dated October 12,1992 issued by SEBI to all stock exchanges, the stock exchanges are required to utilize 20% of the listing fees for providing services to the investing public but it has been noticed that these funds are not being properly utilized by the exchanges. It is suggested that the funds allocated for investor services lying idle with the stock exchanges and the consumer Protection Fund lying with regional exchanges should be transferred to Investor Education Fund and the cost and expenses in relation to the Office of Ombudsman be paid out of that fund.

Nature of Complaints

Regulations also deal with the nature of complaints the Ombudsman is entitled to receive, empowers the ombudsman to receive complaints against the listed public companies, public companies which intend to get their securities listed in a recognised stock exchange, Mutual Funds, Collective Investment Scheme and the intermediaries in securities market relating to redressal of grievances of investors in securities, claims of any money in respect of issue or dealing in securities, deficiency in services. Regulation 15 dealing with the procedure for filing the complaints provides that the complaints may be filed either with the Board or Ombudsman relating to non-receipt of refund orders/ allotment letters, non-receipt of dividend by shareholders or unit holders, non-receipt of share certificates/unit certificates, debenture certificates and bonus shares. etc. or any other matter as may be specified by the Board.

Manner of Resolution of Dispute

Regulations empowers the Ombudsman to consider such complaints and facilitate resolution through mutual agreement, or mediation and on failure of these to adjudicate any claim against the listed company or intermediary in respect of buying or selling of or dealing in securities.

Power to Call for Information

With a view to enable the ombudsman to carryout its duties, regulation 16 empowers the Ombudsman to call for information or any document relating to the subject matter of the complaint from the listed company/intermediary or any other person, institution or authority. However, the Ombudsman has been put under an obligation to maintain the confidentially of any information and document received by him.

Procedure for filing complaint

Regulation 15 which deals with procedural aspects contemplates a simplified procedure. The aggrieved person may file the complaint in the specified form either himself or through his authorised agent. The complaints may be filed directly with the Ombudsman or to SEBI Board. The complaints received by SEBI shall be forwarded to the Ombudsman or the Stipendiary Ombudsman. This regulations require that before making the complaint to SEBI/Ombudsman the aggrieved person shall ensure that he had made a representation to the company or intermediary and the same has been rejected or no reply has been received within one month and the complaint is not in respect of the same matter which has been settled through the Ombudsman and the complaint is made within one year of the cause of action.

Regulation 19 entitles an aggrieved party to an award on adjudication to make an application to the Board for re-examination of the award. The regulation provides a time of 45 days, within which SEBI has to pass appropriate order on such application within 45 days.

Regulation 20 provides that the Ombudsman may award reasonable compensation, costs of the proceedings and stipulate interest to be paid by the party against whom the award has been made till the award is implemented.

Regulation 21 provides that any party which fails to implement the award shall be liable for action under section 15C of the SEBI Act, suspension of trading or delisting of securities, suspension or cancellation of registration, debarment from accessing the Securities market or dealing in securities etc. and such other action which may be deemed appropriate.

Display of the Particulars of the Ombudsman

Regulation 22 & 23, deals with the display of the particulars of the ombudsman in office premises and documents and consequences of non-display or failure to give information. In fact, as a matter of disclosure to investor and investor awareness it has been provided that the listed companies and the intermediaries shall be required to display the name and address of the Ombudsman to whom the complaints are to be made by the aggrieved party in their office premises in such a manner that the visiting shareholders and investors can take notice. The listed companies and the intermediaries are also required to disclose in their offer documents or clients' agreement, the grievance redressal mechanism through Ombudsman. Regulation 23 provides for the consequences of non display or the failure to display the information or furnish information to the Ombudsman would attract penalty under section 15A of the SEBI Act.

CORPORATE GOVERNANCE RATING – A TOOL FOR INVESTOR PROTECTION

Studies show that investors are willing to pay more for corporates that follow good governance practices. But how the investors could know that a particular company follows good governance practice? The answer is rating of the governance practices by specified and independent agencies, evaluating a company's openness (information transparency); reviewing its governing bodies record of compliance, scrutiny of its share capital and shareholder risks and a look at its corporate governance history. Each aspect so examined should be awarded certain corporate governance index in accordance with a well conceived corporate governance standards evaluation matrix.

There are agencies in India and abroad assigning ratings to corporate governance practices in a company. These agencies indicate their current opinion on the relative level to which an organisation accepts and follows the codes and guidelines of corporate governance practices. Generally, rating agencies base their analysis and evaluation on fairness, transparency and responsibilities including the ownership structure, management structure and board level issues, quality of financial reporting and other disclosures, and the fulfillment of interests of the stakeholders.

It may be emphasised that the corporate governance should be viewed in the larger context and thus the ratings should also include social responsiveness of the companies, concern for environmental issues, sustainable developments, and humane governance.

REFERENCES

1. Annual Reports, SEBI.
2. Operational Review, SEBI.
3. Strategic Action Plan, SEBI.
4. Press Releases, SEBI.
5. SEBI Discussion Paper on Innovations in The Securities Market.
6. Kumarmangalam Birla Committee Report on Corporate Governance.
7. Report of SEBI Committee on Corporate Governance.
8. Concept Paper on Ombudsman for Securities Market.
9. SEBI (Disclosure & Investor Protection), Guidelines, 2000 and Circular SEBI/CFD/DIL/DIP Circular No.11 dated August 14,2003.

INTEREST RATE DERIVATIVES — AN INDISPENSABLE PREREQUISITE

MONIKA GOEL*

INTRODUCTION

The opening of the economy and the adoption of the liberalized policies have exposed the business houses to various risks such as exchange rate risk, interest rate risk, economic risk and political risk and thus created the need for hedging instruments for enterprises to minimise the risk.

In the present times, when deregulated interest rates on most debt instruments is continuously exposing the market players to risks arising from unanticipated movements in interest rates, it has become indispensable to hedge this risk. The sharp fall in interest rate in the last five years has spelt down financial institutions, insurance companies provident funds and millions of depositors. While reduction in the interest rate provided some soccour to the government in mopping up resources from the market, it was providing to be a dampner to depositors.

In the fiscal backdrop, for last many years India's fiscal deficit has been around 10% of the GDP and over this period, we have witnessed a big scale of primary issuance of Government debt. The Reserve Bank has been engaged in managing the position of Indian rupee with the help of open market operations. All this has led to the demand of an efficient and liquid bond market. In a survey, jointly sponsored by National Stock Exchange and Geojit Securities, 95.74 of the respondents stressed that there was a need for interest rate derivatives to be traded on exchanges.

INTEREST RATE DERIVATIVES

Under the guidelines issued by the Reserve Bank, interest rates derivatives have been launched in India on National Stock Exchange and Bombay Stock Exchange on June,24, 2003. This has enabled the Scheduled Commercial Banks (SCBs) (excluding Regional Rural Banks and Local Area Banks), Primary dealers and specified All India Financial Institutions, to hedge the interest rate risk in their underlying government securities portfolio by booking a future transaction on payment of a small premium to insure the unexpected liability that may arise in future.

To begin with, it has been decided by RBI to start trading in only two kinds of interest rate futures contracts on the following underlying securities

- Notional Treasury Bills
- Notional 10 year bonds (coupen bearing and non- coupen bearing)

METHODOLOGY FOR INTEREST RATE DERIVATIVES

Derivative is an instrument, which derives its value from the underlying asset. As mentioned earlier, at present notional treasury bills and notional 10 years security bonds have been allowed as underlying instruments in the interest rate derivative market. There can be spot and futures contracts on these underlying securities. The spot market contract is a contract where the transaction settles at a current date whereas in the futures market contract, settlement of a transaction happens at a future date while all other financial aspects of a transaction are fixed today. For example, X agrees to buy 4000 notional 10-year bonds expiring on 31st October,2003 @ Rs.50/-. On 31st October, if the price of the bond is Rs.60/-,he will get Rs.40,000/- i.e the difference between the agreed price and the market price. Similarly, if the price is Rs. 40/- he will have to pay Rs.40,000/-. This is because of "cash settlement" in the interest rate derivative market. There can be three kinds of transactions in the futures market:

1. Speculation
2. Arbitrage

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

3. Hedging

We shall discuss all one by one.

1. **Speculation**

A speculator is one who enters into a transaction with his forecast about the market trend. If he takes a short position and markets fall, he ends up making money and vice versa. Similarly, if he thinks that the interest rates will go down and buys interest rate futures but if interest rates rise, he tends to lose.

2. **Arbitrage**

Arbitrage is a transaction where one creates a locked in position by entering into two transactions, simultaneously, one in spot market and the other in futures market, thereby making profit out of the difference between the two. On a future date both the transactions are reversed to square up the open positions. Arbitrage opportunities arise out of inefficient market.

Suppose, the futures price is higher than the spot price (capitalized to future date at current rate of interest) then, to get the benefit of arbitrage, one must sell at a futures date. For example, in such a case, if one agrees to deliver a 90-day Treasury bill 30 days from now, he must,

a. Buy a zero coupon bond with 120 days to expiry

b. Short the 90 days futures with 30 days to expiration.

This is known as cash and carry arbitrage. It is possible only when,

$$F > S(1+r_{30/365})^{30/365}$$

where,

F is futures market rate

S is spot market rate

r is rate of interest

In the opposite situation, where futures rate is lower than the spot rate (capitalized to future date at current rate of interest), one must sell at the spot market. If he sells 120 days bond, he should invest it into 30 day Treasury bill at spot market and buy 90 days Treasury bill in future market. This is known as "reverse cash and carry". At present, we don't have securities lending system; therefore, reverse cash and carry is limited in this example only to people who have 120 days bond in hand. Secondly, on expiration date, we are left with 90 days bond in hand, which is exactly where we would have been, if we had not entered into any transaction. The aforementioned transaction would be profitable only if the 30 days spot rate is higher than the futures rate and we are left holding cash in hand

3. **Hedging**

Hedging is done to prevent unfavorable movement in interest rate, which may increase the liability of the borrower on the repayment date. The intention behind hedging is not to make profit but to contain the risk of loss. Therefore, if you have a payment liability on a future date and there is 1 base point rise in yield curve, you may have shortage of funds. To hedge this uncertainty, find a futures position, which completely offsets this loss. For example, if you have 100 crores with duration of 11 years. One base point rise in yield curve will increase your liability by Rs.11 lakhs. You have to look for a short future position of Rs.110 crore which gains Rs.11 lakhs if the yield curve moves up by 1bps (considering the parallel shift of yield curve).

TRADING OF INTEREST RATE DERIVATIVES-PROCEDURE

Contract Period

The interest rate future contract is for a period of maturity of one year with three months continuous contracts for the first three months and fixed quarterly contracts for the entire year. New contracts are introduced on the trading day following the expiry of the next month contract. For example, if a contract is to be entered in June 2003, it can have expiry(s) on the last Thursdays in the months of July, August, September, December 2003 and March, 2004.

Expiry Day

Interest rate future contracts expire on the last Thursday of the expiry month. If the last Thursday is a trading holiday, the contracts expire on the previous trading day.

Characteristics of a Contract

Contract underlying	*Notional 10 year bond (6 % coupon)*	*Notional 10 year zero coupon bond*	*Notional 91 day T-Bill*
Contract Value		Rs. 2,00,000	
Lot size		2000	
Tick size		Re.0.01	
Price limits	Not applicable		
Settlement Price	As may be stipulated by NSCCL in this regard from time to time.		

Therefore, an interest rate futures contract can be entered for a minimum lot size of 2000 @ Rs.100/- (base price) leading to a minimum contract value of Rs.200,000. There are no price caps on futures contract as on date.

Base Price & Operating Ranges

Base price of the Interest rate future contracts on introduction of new contracts is theoretical futures price computed based on previous days' closing price of the notional underlying security. The base price of the contracts on subsequent trading days will be the closing price of the futures contracts. However, on such of those days when the contracts are not traded, the base price will be the daily settlement price of futures contracts. In this way there can be different closing and opening base prices of the interest rate futures contract if there is a gap due to trading holiday.

There will be no day minimum/maximum price ranges applicable for the futures contracts. However, in order to prevent / take care of erroneous order entry, the operating ranges for interest rate future contracts is kept at +/- 2% of the base price. In respect of orders, which have come under price freeze, the members would be required to confirm to the Exchange that the order is genuine. On such confirmation, the Exchange at its discretion may approve such order. If such a confirmation is not given by any member, the order is not processed and as such lapses.

CLEARING AND SETTLEMENT

1. **Settlement Procedure & Settlement Price**

   Daily Mark to Market Settlement and Final Settlement for Interest Rate Futures Contract

   — Daily Mark to Market Settlement and Final Mark to Market settlement in respect of admitted deals in Interest Rate Futures Contracts is cash settled by debiting/ crediting of the clearing accounts of Clearing Members with the respective Clearing Bank.

   — All positions (brought forward, created during the day, closed out during the day) of F&O Clearing Member in Futures Contracts, at the close of trading hours on a day, are marked to market at the Daily Settlement Price (for Daily Mark to Market Settlement) and settled.

   — All positions (brought forward, created during the day, closed out during the day) of F&O Clearing Member in Futures Contracts, at the close of trading hours on the last trading day, are marked to market at Final Settlement Price (for Final Settlement) and settled.

   — Open positions in a Futures contract cease to exist after its expiration day.

2. **Daily Settlement Price**

   Daily settlement price for an Interest Rate Futures Contract is the closing price of such Interest Rate Futures Contract on the trading day. The closing price for an interest rate futures contract is calculated on the basis of the last half an hour weighted average price of such interest rate futures contract. In absence of trading in the last half an hour, the theoretical price is taken or such other price as may be decided by the relevant authority from time to time.

   Theoretical daily settlement price for unexpired futures contracts is the futures prices computed using the (price of the notional bond) spot prices arrived at from the applicable Zero Coupon Yield Curve (ZCYC). The ZCYC is computed from the prices of Government securities traded on the Exchange or reported on the Negotiated Dealing System of RBI or both taking trades of same day settlement (i.e. t = 0).

In respect of zero coupon notional bonds, the price of the bond is the present value of the principal payment discounted using discrete discounting for the specified period at the respective zero coupon yields. In respect of the notional T-bill, the settlement price is 100 minus the annualized yield for the specified period computed using the zero coupon yield curve. In respect of coupon bearing notional bond, the present value is obtained as the sum of present value of the principal payment discounted at the relevant zero coupon yield and the present values of the coupons obtained by discounting each notional coupon payment at the relevant zero coupon yield for that maturity. For this purpose the notional coupon payment date shall be half yearly and commencing from the date of expiry of the relevant futures contract.

For computation of futures prices from the price of the notional bond (spot prices) thus arrived, the rate of interest may be the relevant. Mumbai Interbank Offered Rate (MIBOR) rate or such other rate as may be specified from time to time.

3. **Final Settlement Price for mark to market settlement of interest rate futures contracts**

Final settlement price for an Interest rate Futures Contract on zero coupon notional bond and coupon bearing bond is based on the price of the notional bond determined using the zero coupon yield curve computed as explained above. In respect of notional T-bill it shall be 100 minus the annualised yield for the specified period computed using the zero coupon yield curve.

4. **Settlement value in respect of notional T-bill**

Since the T-bills are priced at 100 minus the relevant annualised yield, the settlement value is arrived at using the relevant multiplier factor. Currently it shall be 91/365

5. **Zero Coupon Yield Curve (ZCYC)**

The calculation of all the futures rates at the exchange is done on the basis of zero coupon yield curve. Therefore, if one knows ZCYC, he knows all forward rates of coupon bearing as well as non-coupon bonds. A coupon bearing bond may be said as portfolio of zero coupon bonds. NSE's ZCYC database is based on value weighted averages of wholesale debt market from 1st January, 1997. In easy words, Zero Coupon yield curve is pricing of a set of cash flows over a period of time through calculation of Net Present Value of a security for the period involved.

STRENGTHS OF THE INTEREST RATE DERIVATIVE SYSTEM AND ITS FUTURE PERSPECTIVE

We have on-line and systematised exchange infrastructure and zero coupon bond is the simplest product for speculation and hedging. The cash settlement system avoids all concerns about short selling and clearing and settlement infrastructure of the bond market. In times to come, we may foresee MIBOR as an underlying with many more maturities as against present 90 days and 10-year notional treasury bills and bonds. The interest rate derivative market has yet a long way to go.

REFERENCES

1. www.nseindia.com.
2. www.rbi.org.
3. www.igidr.ac.in.
4. www.mayin.org/ajayshah/fixedincome/index.html.
5. Susan Thomas, Interest Rate Futures.
6. Newspapers and magazines.

TEXT OF THE CLAUSE 49 OF THE LISTING AGREEMENT
(As Revised by the SEBI on August 26,2003)*

1. SEBI, vide its circular dated February 21, 2000, specified principles of corporate governance and introduced a new clause 49 in the Listing agreement of the Stock Exchanges. These principles of corporate governance were made applicable in a phased manner and all the listed companies with the paid up capital of Rs 3 crores and above or net worth of Rs 25 crores or more at any time in the history of the company, were covered as of March 31, 2003. SEBI has issued six circulars on the subject of corporate governance inter-alia detailing provisions of corporate governance, its applicability, reporting requirements etc. which are as follows–

Sr. No.	*Reference no.*	*Subject*	*Date*
1.	SMDRP/POLICY/ CIR-10/2000	Clause 49	February 21,2000
2.	SMDRP/POLICY/ CIR-13/2000	Applicability of Clause 49	March 09, 2000
3.	SMDRP/POLICY/ CIR-42/2000	Amendments to Clause 49	September 12, 2000
4.	SMDRP/POLICY/ CIR- 03/01	Enforcement of Corporate Governance	January 22, 2001
5.	SMDRP/POLICY/ CIR- 19/01	Applicability of Clause 49	March 16,2001
6.	SMDRP/POLICY/ CIR- 53/01	Amendments to Clause 49	December 31,2001

2. In its constant endeavor to improve the standards of corporate governance in India in line with needs of a dynamic market, SEBI constituted a Committee on Corporate Governance under the Chairmanship of Shri N. R. Narayana Murthy. SEBI, based on the recommendations of the Committee and public comments received on the report, has approved certain amendments in the clause 49 of the Listing Agreement.
3. Accordingly, in exercise of powers conferred by section 11 (1) of the Securities and Exchange Board of India Act, 1992 read with section 10 of the Securities Contracts (Regulation) Act 1956, SEBI has revised the clause 49 of the Listing agreement. The revised clause 49 contains both, the sub clauses of existing clause 49 as well as new sub-clauses. All Stock Exchanges are hereby directed to immediately replace the existing Clause 49 of the listing agreement (issued vide circular dated February 21, 2000, September 12, 2000, March 16, 2001 and 31 December 2001) by the revised Clause 49 given in Annexure I. The revised clause 49 also specifies the reporting requirements for the company.
4. Please note that some of the sub-clauses of the revised clause 49 (given in Annexure I) shall be suitably modified or new clauses shall be added following the amendments to the Companies Act 1956 by the Companies (Amendment) Bill/Act 2003, so that the relevant provisions of the clauses on Corporate governance in the Listing Agreement and the Companies Act remain harmonious with one another.
5. The provisions of the revised clause 49 shall be implemented as per the schedule of implementation given below:
   (a) By all entities seeking listing for the first time, at the time of listing.
   (b) By all companies which were required to comply with the requirement of the clause 49 which is proposed to be revised i.e. all listed entities having a paid up share capital of Rs 3 crores and above or net worth of

* SEBI/MRD/SE/2003/26/08

Rs 25 crores or more at any time in the history of the company. The companies shall be required to comply with the requirement of the clause on or before March 31, 2004.

6. The revised clause 49 shall apply to all the listed companies, in accordance with the schedule of implementation given in the revised clause 49. However for other listed entities, which are not companies, but body corporates (e.g. private and public sector banks, financial institutions, insurance companies etc.) incorporated under other statutes, the revised clause will apply to the extent that it does not violate their respective statutes, and guidelines or directives issued by the relevant regulatory authorities. The revised clause is not applicable to the Mutual Fund Schemes.
7. The companies which are required to comply with the requirements of the revised clause 49 shall submit a quarterly compliance report to the stock exchanges as per sub clause (IX) (ii), of the revised clause 49, within 15 days from the quarter ending 31st March 2004. The report shall be submitted either by the Compliance Officer or the Chief Executive Officer of the company after obtaining due approvals.
8. The Stock Exchanges shall ensure that all provisions of corporate governance have been complied with by the company seeking listing for the first time, before granting any new listing. For this purpose, it will be satisfactory compliance if these companies have set up the Boards and constituted committees such as Audit Committee, shareholders/ investors grievances committee etc before seeking listing. A reasonable time to comply with these conditions may be granted only where the Stock Exchange is satisfied that genuine legal issues exists which will delay such compliance. In such cases while granting listing, the stock exchanges shall obtain a suitable undertaking from the company. In case of the company failing to comply with this requirement without any genuine reason, the application money shall be kept in an escrow account till the conditions are complied with.
9. The Stock Exchanges shall set up a separate monitoring cell with identified personnel to monitor the compliance with the provisions of the corporate governance. This cell shall obtain the quarterly compliance report from the companies which are required to comply with the requirements of corporate governance and shall submit a consolidated compliance report to SEBI within 30 days of the end of each quarter.
10. Please note that this is a master circular which contains the revised clause 49 as well as other circulars issued by SEBI on the subject, suitably modified. The companies are required to comply with the provisions of revised clause 49, on or before March 31, 2004. The companies shall continue to comply with all the provisions of clause 49(issued vide circulars dated, 21st February, 2000, 12th September 2000, 16th March 2001 and 31st December 2001) as well as other circulars dated, 9th March 2000 and 22nd January, 2001, till the revised clause 49 of the Listing Agreement is complied with or March 31st 2004, whichever is earlier.

Yours faithfully

Sd/-

V S SUNDARESAN

ANNEXURE - I

Clause 49 - Corporate Governance

The company agrees to comply with the following provisions:

I. Board of Directors

A. Composition of Board

(i) 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 of non-executive directors. The number of independent directors would depend on whether the Chairman is executive or non-executive. In case of a non-executive chairman, at least one-third of board should comprise of independent directors and in case of an executive chairman, at least half of board should comprise of independent directors.

Explanation (i) : For the purpose of this clause, the expression ‘independent director’ shall mean non-executive director of the company who

(a) apart from receiving director’s remuneration, does not have any material pecuniary relationships or transactions with the company, its promoters, its senior management or its holding company, its subsidiaries and associated companies;

(b) is not related to promoters or management at the board level or at one level below the board;

(c) has not been an executive of the company in the immediately preceding three financial years;

(d) is not a partner or an executive of the statutory audit firm or the internal audit firm that is associated with the company, and has not been a partner or an executive of any such firm for the last three years. This will also apply to legal firm(s) and consulting firm(s) that have a material association with the entity.

(e) is not a supplier, service provider or customer of the company. This should include lessor-lessee type relationships also; and

(f) is not a substantial shareholder of the company, i.e. owning two percent or more of the block of voting shares.

Explanation (ii): Institutional directors on the boards of companies shall be considered as independent directors whether the institution is an investing institution or a lending institution.

(B) Non executive directors' compensation and disclosures

(i) All compensation paid to non-executive directors shall be fixed by the Board of Directors and shall be approved by shareholders in general meeting. Limits shall be set for the maximum number of stock options that can be granted to non-executive directors in any financial year and in aggregate. The stock options granted to the non-executive directors shall vest after a period of at least one year from the date such non-executive directors have retired from the Board of the Company.

(ii) The considerations as regards compensation paid to an independent director shall be the same as those applied to a non-executive director.

(iii) The company shall publish its compensation philosophy and statement of entitled compensation in respect of non-executive directors in its annual report. Alternatively, this may be put up on the company's website and reference drawn thereto in the annual report. Company shall disclose on an annual basis, details of shares held by non-executive directors, including on an "if-converted" basis.

(iv) Non-executive directors shall be required to disclose their stock holding (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. These details should accompany their notice of appointment

(C) Independent Director

(i) Independent Director shall however periodically review legal compliance reports prepared by the company as well as steps taken by the company to cure any taint. In the event of any proceedings against an independent director in connection with the affairs of the company, defence shall not be permitted on the ground that the independent director was unaware of this responsibility.

(ii) The considerations as regards remuneration paid to an independent director shall be the same as those applied to a non executive director

(D) Board Procedure

(i) The board meeting shall be held at least four times a year, with a maximum time gap of four months between any two meetings. The minimum information to be made available to the board is given in Annexure–IA.

(ii) A director shall not be a member in more than 10 committees or act as Chairman of more than five committees across all companies in which he is a director. Furthermore it should be a mandatory annual requirement for every director to inform the company about the committee positions he occupies in other companies and notify changes as and when they take place.

Explanation: For the purpose of considering the limit of the committees on which a director can serve, all public limited companies, whether listed or not, shall be included and all other companies (i e private limited companies, foreign companies and companies under Section 25 of the Companies Act, etc) shall be excluded.

(iii) Further only the three committees viz. the

Audit Committee, the Shareholders' Grievance Committee and the Remuneration Committee shall be considered for this purpose.

(E) Code of Conduct

(i) It shall be obligatory for the Board of a company to lay down the code of conduct for all Board members and senior management of a company. This code of conduct shall be posted on the website of the company.

(ii) All Board members and senior management personnel shall affirm compliance with the code on an annual basis. The annual report of the company shall contain a declaration to this effect signed by the CEO and COO.

Explanation: For this purpose, the term "senior management" shall mean personnel of the company who are members of its management/operating council (i.e. core management team excluding Board of Directors). Normally, this would comprise all members of management one level below the executive directors

(F) Term of Office of Non–executive directors

(i) Person shall be eligible for the office of non-executive director so long as the term of office did not exceed nine years in three terms of three years each, running continuously.

II Audit Committee.

A. Qualified and Independent Audit Committee

A qualified and independent audit committee shall be set up and shall comply with the following:

(i) The audit committee shall have minimum three members. All the members of audit committee shall be non-executive directors, with the majority of them being independent.

(ii) All members of audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise.

Explanation (i) : The term "financially literate" means the ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows.

Explanation (ii) : A member will be considered to have accounting or related financial management expertise if he or she possesses experience in finance or accounting, or requisite professional certification in accounting, or any other comparable experience or background which results in the individual's financial sophistication, including being or having been a chief executive officer, chief financial officer, or other senior officer with financial oversight responsibilities.

(iii) The Chairman of the Committee shall be an independent director;

(iv) The Chairman shall be present at Annual General Meeting to answer shareholder queries;

(v) The audit committee should invite such of the executives, as it considers appropriate (and particularly the head of the finance function) to be present at the meetings of the committee, but on occasions it may also meet without the presence of any executives of the company. The finance director, head of internal audit and when required, a representative of the external auditor shall be present as invitees for the meetings of the audit committee;

(vi) The Company Secretary shall act as the secretary to the committee.

(B) Meeting of Audit Committee

The audit committee shall meet at least thrice a year. One meeting shall be held before finalization of annual accounts and one every six months. The quorum shall be either two members or one third of the members of the audit committee, whichever is higher and minimum of two independent directors.

(C) Powers of Audit Committee

The audit committee shall have powers which should include the following:

1. To investigate any activity within its terms of reference.
2. To seek information from any employee.
3. To obtain outside legal or other professional advice.
4. To secure attendance of outsiders with relevant expertise, if it considers necessary.

(D) Role of Audit Committee

(i) The role of the audit committee shall include the following:

1. Oversight of the company's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.
2. Recommending the appointment and removal of external auditor, fixation of audit fee and also approval for payment for any other services.
3. Reviewing with management the annual financial statements before submission to the board, focusing primarily on;
   - (a) Any changes in accounting policies and practices.
   - (b) Major accounting entries based on exercise of judgment by management.
   - (c) Qualifications in draft audit report.
   - (d) Significant adjustments arising out of audit.
   - (e) The going concern assumption.
   - (f) Compliance with accounting standards.
   - (g) Compliance with stock exchange and legal requirements concerning financial statements
   - (h) Any related party transactions
4. Reviewing with the management, external and internal auditors, the adequacy of internal control systems.
5. Reviewing the adequacy of internal audit function, including the structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure coverage and frequency of internal audit.
6. Discussion with internal auditors any significant findings and follow up there on.
7. Reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the board.
8. Discussion with external auditors before the audit commences about nature and scope of audit as well as post-audit discussion to ascertain any area of concern.
9. Reviewing the company's financial and risk management policies.
10. To look into the reasons for substantial defaults in the payment to the depositors, debenture holders, shareholders (in case of non payment of declared dividends) and creditors.

Explanation (i): The term "related party transactions" shall have the same meaning as contained in the Accounting Standard 18, Related Party Transactions, issued by The Institute of Chartered Accountants of India.

Explanation (ii): If the company has set up an audit committee pursuant to provision of the Companies Act, the company agrees that the said audit committee shall have such additional functions / features as is contained in the Listing Agreement.

(E) Review of information by Audit Committee

(i) The Audit Committee shall mandatorily review the following information:

1. Financial statements and draft audit report, including quarterly / half-yearly financial information;
2. Management discussion and analysis of financial condition and results of operations;
3. Reports relating to compliance with laws and to risk management;
4. Management letters / letters of internal control weaknesses issued by statutory / internal auditors; and
5. Records of related party transactions
6. The appointment, removal and terms of remuneration of the Chief internal auditor shall be subject to review by the Audit Committee

III. Audit Reports and Audit Qualifications

A. Disclosure of Accounting Treatment

In case it has followed a treatment different from that prescribed in an Accounting Standards, management shall justify why they believe such alternative treatment is more representative of the underlined business transactions. Management shall also clearly explain the alternative accounting treatment in the footnote of financial statements.

IV. Whistle Blower Policy

(A) Internal Policy on access to Audit Committees:

(i) Personnel who observe an unethical or improper practice (not necessarily a violation of law) shall be able to approach the audit committee without necessarily informing their supervisors.

(ii) Companies shall take measures to ensure that this right of access is communicated to all employees through means of internal circulars, etc. The employment and other personnel policies of the company shall contain provisions protecting "whistle blowers" from unfair termination and other unfair or prejudicial employment practices.

(iii) Company shall annually affirm that it has not denied any personnel access to the audit committee of the company (in respect of matters involving alleged misconduct) and that it has provided protection to "whistle blowers" from unfair termination and other unfair or prejudicial employment practices.

(iv) Such affirmation shall form a part of the Board report on Corporate Governance that is required to be prepared and submitted together with the annual report.

(v) The appointment, removal and terms of remuneration of the chief internal auditor shall be subject to review by the Audit Committee.

V. Subsidiary Companies

(i) The company agrees that provisions relating to the composition of the Board of Directors of the holding company shall be made applicable to the composition of the Board of Directors of subsidiary companies.

(ii) At least one independent director on the Board of Directors of the holding company shall be a director on the Board of Directors of the subsidiary company.

(iii) The Audit Committee of the holding company shall also review the financial statements, in particular the investments made by the subsidiary company.

(iv) The minutes of the Board meetings of the subsidiary company shall be placed for review at the Board meeting of the holding company.

(v) The Board report of the holding company should state that they have reviewed the affairs of the subsidiary company also.

VI. Disclosure of contingent liabilities

(i) The company agrees that management shall provide a clear description in plain English of each material contingent liability and its risks, which shall be accompanied by the auditor's clearly worded comments on the management's view. This section shall be highlighted in the significant accounting policies and notes on accounts, as well as, in the auditor's report, where necessary.

VII. Disclosures

(A) Basis of related party transactions

(i) A statement of all transactions with related parties including their basis shall be placed before the Audit Committee for formal approval/ratification. If any transaction is not on an arm's length basis, management shall provide an explanation to the Audit Committee justifying the same.

(B) Board Disclosures –Risk management

(i) It shall put in place procedures to inform Board members about the risk assessment and minimization procedures. These procedures shall be periodically reviewed to ensure that executive management controls risk through means of a properly defined framework.

(ii) Management shall place a report certified by the compliance officer of the company, before the entire Board of Directors every quarter documenting the business risks faced by the company, measures to address and minimize such risks, and any limitations to the risk taking capacity of the corporation. This document shall be formally approved by the Board.

(C) Proceeds from Initial Public Offerings (IPOs)

(i) When money is raised through an Initial Public Offering (IPO) it shall disclose to the Audit Committee, the uses / applications of funds by major category (capital expenditure, sales and marketing, working capital, etc), on a quarterly basis as a part of their quarterly declaration of financial results. Further, on an annual basis, the company shall prepare a statement of funds utilized for purposes other than those stated in the offer document/ prospectus. This statement shall be certified by the independent auditors of the company. The audit committee shall make appropriate recommendations to the Board to take up steps in this matter.

(D) Remuneration of Directors

(a) All pecuniary relationship or transactions of the non-executive director's vis-a-vis the company shall be disclosed in the Annual Report.

(ii) Further the following disclosures on the remuneration of directors shall be made in the section on the corporate governance of the annual report.

(a) All elements of remuneration package of all the directors i.e. salary, benefits, bonuses, stock options, pension etc.

(b) Details of fixed component and performance linked incentives, along with the performance criteria.

(c) Service contracts, notice period, severance fees.

(d) Stock option details, if any – and whether issued at a discount as well as the period over which accrued and over which exercisable.

(E) Management

(i) As part of the directors' report or as an addition there to, a Management Discussion and Analysis report should form part of the annual report to the shareholders. This Management Discussion & Analysis should include discussion on the following matters within the limits set by the company's competitive position:

(a) Industry structure and developments.

(b) Opportunities and Threats.

(c) Segment–wise or product-wise performance.

(d) Outlook.

(e) Risks and concerns.

(f) Internal control systems and their adequacy.

(g) Discussion on financial performance with respect to operational performance.

(h) Material developments in Human Resources / Industrial Relations front, including number of people employed.

Management shall make disclosures to the board relating to all material financial and commercial transactions, where they have personal interest, that may have a potential conflict with the interest of the company at large (for e.g. dealing in company shares, commercial dealings with bodies, which have shareholding of management and their relatives etc.)

(F) Shareholders

(i) In case of the appointment of a new director or re-appointment of a director the shareholders must be provided with the following information:

(a) A brief resume of the director;

(b) Nature of his expertise in specific functional areas; and

(c) Names of companies in which the person also holds the directorship and the membership of Committees of the board.

(ii) Information like quarterly results, presentation made by companies to analysts shall be put on company's web-site, or shall be sent in such a form so as to enable the stock exchange on which the company is listed to put it on its own web-site.

(iii) A board committee under the chairmanship of a non-executive director shall be formed to specifically look into the redressal of shareholder and investors complaints like transfer of shares, non-receipt of balance sheet, non-receipt of declared dividends etc. This Committee shall be designated as 'Shareholders/Investors Grievance Committee'.

(iv) To expedite the process of share transfers the board of the company shall delegate the power of share transfer to an officer or a committee or to the registrar and share transfer agents. The delegated authority shall attend to share transfer formalities at least once in a fortnight.

VIII. CEO/CFO certification

(i) CEO (either the Executive Chairman or the Managing Director) and the CFO (whole-time Finance Director or other person discharging this function) of the company shall certify that, to the best of their knowledge and belief:

(a) They have reviewed the balance sheet and profit and loss account and all its schedules and notes on accounts, as well as the cash flow statements and the Directors' Report;

(b) These statements do not contain any materially untrue statement or omit any material fact nor do they contain statements that might be misleading;

(c) These statements together present a true and fair view of the company, and are in compliance with the existing accounting standards and / or applicable laws / regulations;

(d) They are responsible for establishing and maintaining internal controls and have evaluated the effectiveness of internal control systems of the company; and they have also disclosed to the auditors and the Audit Committee, deficiencies in the design or operation of internal controls, if any, and what they have done or propose to do to rectify these;

(e) They have also disclosed to the auditors as well as the Audit Committee, instances of significant fraud, if any, that involves management or employees having a significant role in the company's internal control systems; and

(f) They have indicated to the auditors, the Audit Committee and in the notes on accounts, whether or not there were significant changes in internal control and / or of accounting policies during the year.

IX. Report on Corporate Governance

(i) There shall be a separate section on Corporate Governance in the annual reports of company, with a detailed compliance report on Corporate Governance. Non-compliance of any mandatory requirement i.e. which is part of the listing agreement with reasons thereof and the extent to which the non-mandatory requirements have been adopted should be specifically highlighted. The suggested list of items to be included in this report is given in Annexure-1B and list of non-mandatory requirements is given in Annexure –1C.

(ii) The companies shall submit a quarterly compliance report to the stock exchanges within 15 days from the close of quarter as per the format given below. The report shall be submitted either by the Compliance Officer or the Chief Executive Officer of the company after obtaining due approvals.

Format of Quarterly Compliance Report on Corporate Governance

Name of the Company:

Quarter ending on:

Particulars	*Clause of Listing Agreement*	*Compliance status (Yes/No/N.A.)*	*Remarks*
1	*2*	*3*	*4*
I. Board of Directors	49 I		
(A) Composition of Board	49 (IA)		
(B) Non-executive Directors' compensation & disclosures	(IB)		
(C) Independent Director	(IC)		
(D) Board Procedure	9 (ID)		
(E) Code of Conduct	9 (IE)		
(F) Term of office of non-executive directors	49 (IF)		
II. Audit Committee	9 (II)		
(A) Qualified & Independent Audit Committee	9 (IIA)		
(B) Meeting of Audit Committee	9 (IIB)		
(C) Powers of Audit Committee	9 (IIC)		
(D) Role of Audit Committee	II(D)		
(E) Review of Information by Audit Committee	49 (IIE)		
III. Audit Reports and Audit Qualifications	49 (III)		
IV. Whistle Blower Policy	49 (IV)		
V. Subsidiary Companies	49 (V)		
VI. Disclosure of contingent liabilities	49 (VI)		

1	2	3	4
VII. Disclosures	49 (VII)		
(A) Basis of related party transactions	(II A)		
(B) Board Disclosures	(VIIB)		
(C) Proceeds from Initial Public offerings	49 (VIIC)		
(D) Remuneration of Directors	49 (VIID)		
(E) Management	(VIIE)		
(F) Shareholders	49 (VIIF)		
VIII.CEO/CFO Certification	49 (VIII)		
IX. Report on Corporate Governance	49 (IX)		
X. Compliance	49 (X)		

Note:

(1) The details under each head shall be provided to incorporate all the information required as per the provisions of the clause 49 of the Listing Agreement.

(2) In the column No.3, compliance or non-compliance may be indicated by Yes/No/N.A.. For example, if the Board has been composed in accordance with the clause 49 I of the Listing Agreement, "Yes" may be indicated. Similarly, in case the company has not come out with an IPO, the words "N.A." may be indicated against 49 (VIIC).

(3) In the remarks column, reasons for non-compliance may be indicated, for example, in case of requirement related to circulation of information to the shareholders, which would be done only in the AGM/EGM, it might be indicated in the "Remarks" column as – "will be complied with at the AGM". Similarly, in respect of matters which can be complied with only where the situation arises, for example, "Report on Corporate Governance" is to be a part of Annual Report only, the words "will be complied in the next Annual Report" may be indicated.

X. Compliance

The company shall obtain a certificate from either the auditors or practicing company secretaries regarding compliance of conditions of corporate governance as stipulated in this clause and annex the certificate with the directors' report, which is sent annually to all the shareholders of the company. The same certificate shall also be sent to the Stock Exchanges along with the annual returns filed by the company.

Schedule of implementation

(1) The provisions of the revised clause 49 shall be implemented as per the schedule of implementation given below:

(i) By all entities seeking listing for the first time, at the time of listing.

(ii) By all companies which were required to comply with the requirement of the erstwhile clause 49 i.e. all listed entities having a paid up share capital of Rs 3 crores and above or net worth of Rs 25 crores or more at any time in the history of the entity. These entities shall be required to comply with the requirement of this clause on or before March 31, 2004.

(2) The non-mandatory requirement given in Annexure – 1C shall be implemented as per the discretion of the company. However, the disclosures of the adoption/non-adoption of the non-mandatory requirements shall be made in the section on corporate governance of the Annual Report.

Annexure 1A

Information to be placed before Board of Directors

1. Annual operating plans and budgets and any updates.

2. Capital budgets and any updates.

3. Quarterly results for the company and its operating divisions or business segments.
4. Minutes of meetings of audit committee and other committees of the board.
5. The information on recruitment and remuneration of senior officers just below the board level, including appointment or removal of Chief Financial Officer and the Company Secretary.
6. Show cause, demand, prosecution notices and penalty notices which are materially important.
7. Fatal or serious accidents, dangerous occurrences, any material effluent or pollution problems.
8. Any material default in financial obligations to and by the company, or substantial non-payment for goods sold by the company.
9. Any issue, which involves possible public or product liability claims of substantial nature, including any judgement or order which, may have passed strictures on the conduct of the company or taken an adverse view regarding another enterprise that can have negative implications on the company.
10. Details of any joint venture or collaboration agreement.
11. Transactions that involve substantial payment towards goodwill, brand equity, or intellectual property.
12. Significant labour problems and their proposed solutions. Any significant development in Human Resources/ Industrial Relations front like signing of wage agreement, implementation of Voluntary Retirement Scheme etc.
13. Sale of material nature, of investments, subsidiaries, assets, which is not in normal course of business.
14. Quarterly details of foreign exchange exposures and the steps taken by management to limit the risks of adverse exchange rate movement, if material.
15. Non-compliance of any regulatory, statutory nature or listing requirements and shareholders service such as non-payment of dividend, delay in share transfer etc.

Annexure 1B

Suggested List of Items to Be Included In the Report on Corporate Governance in the Annual Report of Companies

1. A brief statement on company's philosophy on code of governance.
2. Board of Directors:
   (i) Composition and category of directors, for example, promoter, executive, non- executive, independent non-executive, nominee director, which institution represented as lender or as equity investor.
   (ii) Attendance of each director at the BoD meetings and the last AGM.
   (iii) Number of other BoDs or Board Committees in which he/she is a member or Chairperson.
   (iv) Number of BoD meetings held, dates on which held.
3. Audit Committee.
   (i) Brief description of terms of reference
   (ii) Composition, name of members and Chairperson
   (iii) Meetings and attendance during the year
4. Remuneration Committee.
   (i) Brief description of terms of reference
   (ii) Composition, name of members and Chairperson
   (iii) Attendance during the year
   (iv) Remuneration policy
   (v) Details of remuneration to all the directors, as per format in main report.
5. Shareholders Committee.
   (i) Name of non-executive director heading the committee
   (ii) Name and designation of compliance officer
   (iii) Number of shareholders' complaints received so far
   (iv) Number not solved to the satisfaction of shareholders
   (v) Number of pending complaints
6. General Body meetings.
   (i) Location and time, where last three AGMs held.
   (ii) Whether any special resolutions passed in the previous 3 AGMs

(iii) Whether any special resolution passed last year through postal ballot – details of voting pattern

(iv) Person who conducted the postal ballot exercise

(v) Whether any special resolution is proposed to be conducted through postal ballot

(vi) Procedure for postal ballot

7. Disclosures.

(i) Disclosures on materially significant related party transactions that may have potential conflict with the interests of company at large.

(ii) Disclosure of accounting treatment, if different, from that prescribed in Accounting standards with explanation.

(iii) Details of non-compliance by the company, penalties, strictures imposed on the company by Stock Exchange or SEBI or any statutory authority, on any matter related to capital markets, during the last three years.

(iv) Whistle Blower policy and affirmation that no personnel has been denied access to the audit committee.

8. Means of communication.

(i) Half-yearly report sent to each household of shareholders.

(ii) Quarterly results

(iii) Newspapers wherein results normally published

(iv) Any website, where displayed

(v) Whether it also displays official news releases; and

(vi) The presentations made to institutional investors or to the analysts.

(vii) Whether MD&A is a part of annual report or not.

9. General Shareholder information

(i) AGM : Date, time and venue

(ii) Financial Calendar

(iii) Date of Book closure

(iv) Dividend Payment Date

(v) Listing on Stock Exchanges

(vi) Stock Code

(vii) Market Price Data : High., Low during each month in last financial year

(viii) Performance in comparison to broad-based indices such as BSE Sensex, CRISIL index etc.

(ix) Registrar and Transfer Agents

(x) Share Transfer System

(xi) Distribution of shareholding

(xii) Dematerialization of shares and liquidity

(xiii) Outstanding GDRs/ADRs/Warrants or any Convertible instruments, conversion date and likely impact on equity

(xiv) Plant Locations

(xv) Address for correspondence

Annexure 1C

Non-Mandatory Requirements

1. Chairman of the Board

A non-executive Chairman should be entitled to maintain a Chairman's office at the company's expense and also allowed reimbursement of expenses incurred in performance of his duties.

2. Remuneration Committee

(i) The board should set up a remuneration committee to determine on their behalf and on behalf of the shareholders with agreed terms of reference, the company's policy on specific remuneration packages for executive directors including pension rights and any compensation payment.

(ii) To avoid conflicts of interest, the remuneration committee, which would determine the remuneration packages of the executive directors should comprise of at least three directors, all of whom should be non-executive directors, the chairman of committee being an independent director.

(iii) All the members of the remuneration committee should be present at the meeting.

(iv) The Chairman of the remuneration committee should be present at the Annual General Meeting, to answer the shareholder queries. However, it would be up to the Chairman to decide who should answer the queries.

3. Shareholder Rights

The half-yearly declaration of financial performance including summary of the significant events in last six-months, should be sent to each household of shareholders.

4. Postal Ballot

Currently, though there is requirement for holding the general meeting of shareholders, in actual practice only a small fraction of the shareholders of that company do or can really participate therein. This virtually makes the concept of corporate democracy illusory. It is imperative that this situation which has lasted too long needs an early correction. In this context, for shareholders who are unable to attend the meetings, there should be a requirement which will enable them to vote by postal ballot for key decisions. Some of the critical matters which should be decided by postal ballot are given below:

(i) Matters relating to alteration in the memorandum of association of the company like changes in name, objects, address of registered office etc;

(ii) Sale of whole or substantially the whole of the undertaking;

(a) Sale of investments in the companies, where the shareholding or the voting rights of the company exceeds 25% ;

(b) Making a further issue of shares through preferential allotment or private placement basis;

(c) Corporate restructuring;

(d) Entering a new business area not germane to the existing business of the company;

(e) Variation in rights attached to class of securities;

(f) Matters relating to change in management.

5. Audit qualifications

Company may move towards a regime of unqualified financial statements.

6. Training of Board Members

Company shall train its Board members in the business model of the company as well as the risk profile of the business parameters of the company, their responsibilities as directors, and the best ways to discharge them.

7. Mechanism for evaluating non-executive Board Members

The performance evaluation of non-executive directors should be done by a peer group comprising the entire Board of Directors, excluding the director being evaluated; and Peer Group evaluation should be the mechanism to determine whether to extend/ continue the terms of appointment of non-executive directors.

GLOBALISATION OF PROFESSIONAL SERVICES

DR S K DIXIT*

INTRODUCTION

Pre-Uruguay Round GATT framework applies only to trade in goods, reflecting traditional assumptions that services are not easily tradable. The splintering of services from goods and increasing use of external contracting to obtain service inputs into the production of goods have created new explicit markets for services. As the comparative advantage in the production of many manufactured goods has shifted to new industrialising countries, the developed nations have become increasingly concerned with enhancement of trading opportunities in service sector, particularly in the areas such as financial services, insurance, telecommunications, information technology and professional services. In the light of various developments which have created increased potential for international trade in services, the reduction or elimination of barriers to trade in services became a major priority of a number of developed nations at Uruguay Round negotiations and thus, the trade in services has been included in the WTO framework.

REGULATION OF INTERNATIONAL TRADE – A REVIEW

The creation of the World Trade Organisation (WTO) as a specialized agency of the United Nations Organisation (UNO) ostensibly brings into reality a dream which the architects of UNO wanted to create for the promotion of world trade. The Atlantic Charter of February 12, 1941 had conceived of the United Nations Organisation which envisaged that UNO would include three specialized institutions responsible for global economic management, namely, the International Bank for Reconstruction and Development (IBRD), the International Monetary Fund (IMF) and International Trade Organisation (ITO). The first discussion of idea for an ITO occurred at a meeting in late 1943 between the United States and the United Kingdom in the context of the Lend Lease Agreement. The United States and the United Kigdom produced a set of proposals as the basis of a charter for an international trade organisation. A suggested charter, submitted by the United State in October 1946 contained an extensive catalogue of prohibited trade restrictions as well as the proposal for an exchange of tariff reductions on the basis of reciprocity. The suggested Charter proposed that the ITO would be a specialized agency of the United Nations Organisation under the management of an Executive Board which would also be responsible for the investigation and determination of complaints.

At the Havana Conference a Draft for the International Trade Organisation was completed and signed by participants on 23 March, 1948. An Interim Commission for the ITO (ICITO) was established in Geneva with a permanent secretariat. The Report of the London Preparatory Conference, held in late 1946, had proposed that the general provisions of the ITO Charter dealing with trade policy be incorporated into an agreement in order to safeguard the consensus which had been reached on tariff concessions. Consequently on 30 October, 1947, 23 Governments signed the Final Act of a General Agreement on Tariffs and Trade (GATT). The early sessions of the GATT were taken up with negotiations for tariff concessions and housekeeping affairs. It was during the Fifth Session the United States formally notified the suspension of its ITO rectification efforts.

Multilateral Trade Organisation

The World Trade Organisation was first mooted in February, 1990. In July 1990, the EC submitted its proposal for a Multilateral Trade Organisation (MTO). The EC proposal envisaged the MTO as a structure within the GATT to ensure effective administration and implementation of the Uruguay Round Agreements. The EC proposed that the MTO have the legal capacity of an international organisation as the basis for implementing the results of the Round. The then

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

Director General of GATT, Aurther Dunkel presented to delegates a compilation of the results of negotiations in each sector of the Round. A significant feature of the Dunkel Draft was the inclusion of a Draft Agreement Establishing the Multilateral Trade Organisation (MTO).

The membership of the MTO was to include signatories to the GATT and its associated agreements, including those of the Tokyo Round, and the principal agreements of the Uruguay Round; the General Agreement on Trade in Services (GATS), the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPs), the Integrated Dispute Settlement Understanding and the Trade Policy Review Mechanism. However, the possibility of withholding consent to specific Agreements was provided for. A General Council was proposed for the administration of the MTO between a biennial Ministerial Conference. The General Council was required to establish a Dispute Settlement Body and a Trade Policy Review Mechanism as well as to administer the specific Uruguay Round Agreements such as TRIPs and TRIMs.

THE WORLD TRADE ORGANISATION

The Marrakesh Conference of Trade Ministers accepted the Agreement Establishing the World Trade Organisation as an integral part of the Final Act Embodying the results of the Uruguay Round of Multilateral Trade Negotiations (the Final Act) The Marrakesh Declaration of 15 April, 1994 affirmed that the establishment of the WTO ushered in a new era of global economic cooperation, reflecting the widespread desire to operate in a fairer and more open multilateral trading system.

The preamble to the WTO Agreement recognizes the importance of equating the increase in living standards, full employment, expansion of demand, production and trade in goods and services with the optimal use of the world's resources in accordance with the objective of sustainable developments. The preamble also recognizes the need to 'secure for the developing countries, particularly the least developed, a growth in the share of international trade commensurate with the needs of their economic development'. The preamble affirmed the contribution to those objectives by the entry of members into 'reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs' and other barriers.

The WTO has been established by Article 1 of the WTO Agreement and Article 11 affirmed that it would provide the common institutional framework for the conduct of trade, multilateral and plurilateral trade agreements annexed to the WTO Agreement. Article II provides that the functions of the WTO would include the administration of relevant agreements, as well as providing a forum for negotiations among members concerning their multilateral trade relations. Additionally, the WTO is to administer the disputes settlement mechanism and the Trade Policy Review Mechanism.

Difference between GATT and WTO

Following are the main difference between GATT and WTO

1. GATT was ad hoc and provisional. The General Agreement was never ratified in members Parliaments and it contained no provisions for the creation of an organisation.

   The WTO and its agreements are permanent. As an international organisation, the WTO has a sound legal basis because members have ratified the WTO agreements, and the agreements themselves describe how WTO is to function.

2. The WTO has 'members', GATT had "contracting parties", underscoring the fact that officially GATT was a legal text.

3. GATT dealt with trade in goods. The WTO covers services and intellectual property as well.

4. The WTO dispute settlement system is faster, more automatic than the old GATT system; its rulings cannot be blocked.

Main purposes of WTO

The overriding purpose of the WTO is to help trade flow as freely as possible, as long as there is no undesirable side effects. It also means ensuring that individual, companies and governments know what the trade rules are around the world and giving them the confidence that there will be no sudden changes of policy. Another important purposes of the WTO is to serve as a forum for trade negotiations. And the third purpose of the WTO is to provide forum for dispute settlement between the parties.

The Principles of Multilateral Trading System

The whole system of multilateral trading as envisaged under WTO is based on certain principles. These fundamental principles run all through various agreements/documents agreed upon by the parties. Accordingly, these principles include non-discrimination, free trade, predictability, competitiveness.

IMPORTANCE OF SERVICE SECTOR

Broadly defined, a service is a product of human activity aimed to satisfy a human need, which does not constitute a tangible commodity. There are many types of services, ranging from heart surgery to road construction, electricity transmission to education, and childcare to water purification. Services are important for employment and employment growth. This is because many traditional services, including distribution, education and social services, are labour intensive. In many services sectors it has also proved more difficult to substitute capital for labour than in manufacturing. The expansion of services has been driven in particular by income-related demand shifts, benefiting for example the hotel and tourist industry; the economic stimulus resulting from new information and communication technologies; and the growing importance of basic infrastructural services, including transport, communication and finance, for a wide range of user industries.

Services have come to dominate the economic activities of countries at virtually every stage of development, making services trade liberalisation a necessity for the integration of the world economy. In the high-income industrialised economies, the value added by services generally exceeds 60 per cent of total output; for example, 70 per cent in Australia, 71 per cent in France, 60 per cent in Japan, 72 per cent in the United States. In many emerging markets, services account for half or more of economic output; 55 per cent in the Czech Republic, 59 per cent in Hungary, 54 per cent in Poland. The same applies to many advanced developing or newly industrialised economies, such as Argentina, Brazil, Korea, Malaysia, Mexico and Thailand.

In many developing economies as well, the service sector is the single largest contributor to economic output, ahead of either agriculture or industry. Even allowing for the fact that governments are major service providers (education, healthcare, sanitation, etc.), the commercial market for services is huge and growing in virtually every country. And the trend is clear: as national economies develop and incomes rise, the commercial service sector accounts for an ever-larger share of GDP.

Advantages of Liberalisation of Services

It is widely recognised that liberalisation of trade in Services has manifold benefits. Some of them have been given below :

(i) Freer trade in services enables countries to better enjoy the benefits of globalisation and improves economic efficiency just as freer trade in goods does. It contributes to job creation, higher incomes, more consumer choice, downward pressure on inflation, and a better quality of life.

(ii) More, better and lower cost services are important because services are the "enablers" that permit economies to function and prosper.

(iii) For some manufacturers, services provide a large second source of revenues and contribute significantly to company growth and job creation. The manufacturing process and the business of running manufacturing industries are infused with services functions from beginning to end: research and development, inventory management and control, transport, marketing, advertising, insurance, and "backroom" functions, such as accounting and legal services.

(iv) Liberalisation of trade in services is an important means to encourage the continued rapid expansion of foreign direct investment, to integrate national economies more effectively and to reduce income and other disparities among countries. Because services production and consumption normally are proximate and simultaneous, services trade usually entails a significant transfer of technology and know-how from country to country. This is critical, especially for developing and emerging markets, which can acquire state-of-the-art skills relatively quickly and inexpensively through trade - at least in comparison with the time and expense that would be required to develop them de novo.

IMPORTANCE OF SERVICES TRADE

Today the service sector covers wide range of areas such as transport, communication, tourism, software and information technology services and environmental and educational services. During the last two decades, the service sector which has expanded rapidly now play important role in national economies and international trade. In 1997, service sector output was valued at $6.6 trillion or 61 per cent of global output of goods and services. Although the developed countries have dominated this expansion, accounting for three-quarters of world services output, the contribution of services has also increased significantly in developing countries. The growth in service sector output and employment has been accompanied by increased internationalization of service sector transactions. Both foreign direct investment (FDI) and trade in services have grown considerably. Today, the service sector accounts for 40 per cent of the world stock of FDI, at an estimated $30 billion, and for 50 per cent of world FDI flows, the bulk of which is among developed countries. World exports of services are substantial at an estimated $1.4 trillion in 2000, or roughly 23 per cent of global merchandise exports.

India has participated in the globalization of services. In 1999-2000, India's trade in services was estimated at about $30 billion. In certain areas, such as software services, India has carved a niche for itself in the global market while in other areas, such as construction and engineering services, health services, telecommunications and financial services, it has growing trade and investment potential. Given the impending reforms in many of India's service sectors, the importance of services trade and FDI is bound to increase in the Indian economy.

The growing role of services in the national and international economy has been spurred by a variety of factors. The major driving forces are the emergence of transnational corporations, rising demand for services around the world, rapid advances in information and communication technology, and the deregulation and liberalization of many service sector activities with concomitant pressures on costs and productivity. The expansion and globalization of services has important implications given the inter-linkages of services with other sectors of the economy. Services are an important driving force in economic development, competitiveness and productivity. Producer services, such as transport, finance and communications play a vital infrastructure role in the economy with major spill over effects on competitiveness in both goods and services. With rapid improvements in information technology, knowledge-based services have become increasingly important in recent years. International competitiveness today largely depends on technological competence and the ability to adopt, acquire and use knowledge associated with new technologies.

As mentioned above, recognizing the significant and growing role of services in the world and national economies, as well as the various constraints impeding globalization of this sector, the Uruguay Round widened the scope of multilateral trade negotiations to include services for the first time in the history of trade negotiations. A Group on Negotiations for Services was established. The outcome of these negotiations was the General Agreement on Trade in Services or GATS, which came into force on January 1, 1995. This agreement established a multilateral framework to promote transparency and predictability in services trade and to enable progressive liberalization of trade and investment flows in this sector.

GENERAL AGREEMENT ON TRADE IN SERVICES (GATS)

The creation of the GATS was one of the landmark achievements of the Uruguay Round, whose results entered into force in January 1995. The GATS for the first time extended internationally agreed rules and commitments into the rapidly growing area of international trade viz. service, which was never done before. The preamble of GATS expressed desire to facilitate the increasing participation of developing countries in trade in services and the expansion of services exports through the strengthening of their domestic capacity, efficiency and competitiveness.

GATS framework consists of six parts and annexes. The GATS is based on the same objectives as that of GATT of creating a credible and reliable system of international trade rules; ensuring fair and equitable treatment of all participants (principle of non-discrimination); stimulating economic activity through guaranteed policy bindings; and promoting trade and development through progressive liberalisation. Further negotiations for progressive liberalisation commenced by 1.1.2000, as mandated under GATS.

The Doha Ministerial Conference has given further direction to these negotiations by mandating that members should submit initial requests for specific commitments by 30 June 2002 and initial offers by 31 March 2003. The paragraph 15 of the Ministerial Declaration says that "... negotiations on trade in services shall be conducted with a view to promoting the economic growth of all trading partners and the development of developing and least-developed countries. We recognise the work already undertaken in the negotiations, initiated in January 2000 under Article XIX of the General Agreement on Trade in Services, and the large number of proposals submitted by members on a wide range of sectors and several horizontal issues, as well as on movement of natural persons. The declaration further says that "... with a view to achieving the objectives of the General Agreement on Trade in Services, as stipulated in the Preamble, Article IV and Article XIX of that Agreement Participants shall submit initial requests for specific commitments by 30 June 2002 and initial offers by 31 March 2003.

GENERAL AGREEMENT ON TRADE IN SERVICES (GATS) — AN OVERVIEW

The GATS applies in principle to all service sectors except "services supplied in the exercise of governmental authority". These are services that are supplied neither on a commercial basis nor in competition with other suppliers' viz. social security schemes and central banking.

Modes of supply of Services

The GATS sets out four modes of supply of services. These include cross border trade, consumption abroad, commercial presence and movement of natural persons.

GENERAL PRINCIPLES

Following are the basic rules/principles applicable to all members and to all services.

MFN Treatment

Article II of the GATS provides that each Member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than it accords to like services and service suppliers of any other country. However, a member is permitted to maintain a measure inconsistent with the general MFN requirement if it has established an exception. However, all exemptions are subject to review and they should, in principle, not last more than 10 years.

Transparency

The GATS requires each member to publish promptly "all relevant measures of general application" that affect operation of the agreement. Members must also notify the Council for Trade in Services of new or changed laws, regulations or administrative guidelines that affect trade in services covered by their specific commitments under the agreement. Each member is required to establish an enquiry point, to respond to requests from other members for information.

Specific Obligations

Obligations, which apply on the basis of commitments, laid down in individual country schedules concerning market access and national treatment in specifically designated sectors. These requirements apply only to scheduled sectors.

Market Access

Market access is a negotiated commitment in specified sectors. The GATS also sets out different forms of measure affecting free market access that should not be applied to the foreign service or its supplier unless their use is clearly provided for in the schedule. They are:

(i) Limitations on the number of service suppliers.

(ii) Limitations on the total value of services transactions or assets.

(iii) Limitations on the total number of service operations or the total quantity of service output.

(iv) Limitations on the number of persons that may be employed in a particular sector or by a particular supplier Measures that restrict or require supply of the service through specific types of legal entity or joint venture.

(v) Percentage limitations on the participation of foreign capital, or limitations on the total value of foreign investment.

National Treatment

A commitment to national treatment means that in the sectors covered by its schedule, subjected to any conditions and qualifications set out in the schedule, each member shall give treatment to foreign services and service suppliers treatment, in measures affecting supply of services, no less favourable than it gives to its own services and suppliers. The extension of national treatment in any particular sector may be made subject to conditions and qualifications.

Members are free to tailor the sector coverage and substantive content of such commitments as they deem fit. The commitments thus tend to reflect national policy objectives and constraints, overall and in individual sectors. While some Members have scheduled less than a handful of services, others have assumed market access and national treatment disciplines in over 120 out of a total of 160-odd services.

Exemptions

Members in specified circumstances are allowed to introduce or maintain measures in contravention of their obligations under the Agreement, including the MFN requirement or specific commitments. These circumstance cover measures necessary to protect public morals or maintain public order, protect human, animal or plant life or health or secure compliance with laws or regulations not inconsistent with the Agreement including, among others, measures necessary to prevent deceptive or fraudulent practices. Also, in the event of serious balance-of-payments difficulties, members are allowed to temporarily restrict trade, on a non-discriminatory basis, despite the existence of specific commitments.

TRENDS IN TRADE IN SERVICES

(i) Global Trends

According to the WTO, World trade in commercial services is estimated to have decreased by 1 percent (to $ 1.440 trillion) in 2001. This is the first decline of world commercial services trade since 1983. In the period 1990-2000 the annual growth of trade in services was 6 percent and matched that of merchandise trade. Throughout the year 1990-2000, amongst the leading traders in commercial services the most dynamic with exports and imports growing at double-digit rates were China, the Republic of Korea, India, Ireland and Malaysia.

Some of the leading Exporters of Commercial Services, 2001

(Billion dollars and percentage)

Exporters Percentage Change	*Value*	*Share*	*Annual '90-'00*	*2000*	*2001*
United States	262.9	18.3	7	9	-3
United Kingdom	108.3	7.5	8	3	-6
Germany	79.8	5.5	5	-3	-1
France	79.0	5.5	2	-1	-3
Japan	63.3	4.4	5	13	-7
Hong Kong, China	43.0	3.0	9	13	2
Canada	34.7	2.4	7	7	-5
China	31.0	2.2	18	15	3
Republic of Korea	28.4	2.0	12	12	-2
India	**20.1**	**1.4**	**14**	**26**	**14**
Ireland	19.2	1.3	18	8	15
Malaysia	13.6	0.9	14	15	0
World	**1440**	**100**	**6**	**6**	**-1**

Some of the leading Importers of Commercial Services, 2001

(Billion dollars and percentage)

Exporters Percentage Change	*Value*	*Share*	*Annual '90-'00*	*2000*	*2001*
United States	187.6	13.1	7	16	-7
Germany	128.5	9	5	-3	-3
Japan	106.7	7.5	3	1	-8
United kingdom	88.5	6.2	8	2	-5
France	60.0	4.2	2	-3	-2
Canada	39.6	2.8	4	7	-4
China	36.4	2.5	24	16	2
Ireland	33.6	2.4	19	8	17
Republic of Korea	32.6	2.3	13	23	-1
India	**23.7**	**1.7**	**13**	**15**	**21**
Malaysia	16.3	1.1	12	13	-2
World	**1430**	**100**	**6**	**6**	**-1**

The impact of the slowdown in commercial services trade differed largely among the major regions. Most of them including Asia, reported decline in exports and imports in 2001. The downturn in the Asian region was particularly pronounced for Japan (-7%). However, China, Hong Kong-China and India recorded a higher commercial services exports receipts in 2001 with an annual growth rate of 3%, 2% and 14% respectively. India's growth performance in the world services trade is remarkable considering the fact that during the decade 1990-2000 and in 2001 there were only a few countries, which have registered a double digit growth. Among the Asian leaders, India features sixth in the list of exporters and fourth in the list of importers in share of trade terms in 2001, but what is noteworthy is that India is ranked first when annual percentage change for 2001 is considered.

(ii) Services Trade in the Indian Economy

Over the past two decades, the service sector in India has replaced agriculture as the dominant sector. The share of services sector in India's GDP has risen from 38 per cent in 1980-81 to 49 per cent in 2000-01, while the share of the primary sector has fallen from 41 per cent to less than 30 per cent. In 1997-98, value added in services was an estimated $176 billion, roughly twice the size of the secondary sector and one and a half times the size of the primary sector. The service sector employed 179 lakh persons in 1997-98, or 64 per cent of the country's total organized labour force of 282 lakhs. Services trade has undergone considerable growth in India. In 1998, India's service sector exports and imports were $11.7 billion and $14.5 billion, respectively. The service sector accounts for about one quarter of total trade in goods and services, with services exports and imports each constituting about 25 per cent of total exports and total imports, respectively. Nearly 80 per cent of this trade is in transport, travel and other business services. The most notable expansion in recent years has been in the software services sector. Exports of software services have risen from a mere Rs. 0.30 billion in 1985 to Rs. 109.4 billion ($2.65 billion) in 1999 and accounted for 7 per cent of total Indian exports in 1999.

The available data indicate that India's trade in services has more than doubled over the 1991-98 period, although this expansion has not been uniform across sub-sectors. The composition of India's services trade has shifted away from traditional service activities, such as travel and transport towards other business services. This structural change reflects the growth in information technology and software services with their enabling impact on many business activities. A mode wise allocation of India's services trade reveals that except commercial presence (mode-3) all other GATS modes are important. India's main export potential lies in movement of natural persons given its abundance of labour at different levels of skill. Cross-border supply is likely to become increasingly important due to growth in information technology and IT-enabled services. India's imports of services rely mainly on capital imports or FDI although the current scope for such trade is limited by regulations and state owned monopolies in various services. Divestment and privatization in many service sub-sectors is likely to increase the scope for FDI in services. Thus, India's services trade closely reflects its factor endowments.

PROFESSIONAL SERVICES

Professional services have a wide range of activities even though many of them have certain common characteristics. Professional services are services that are primarily purchased by the others. Professional services are mostly in the business of delivering expertise calling for inputs from skilled professional, technical and managerial personnel and comprises a mix of activities, such as accounts, legal and secretarial services, auditing etc. which require some type of accrediting, and few others which are open to all the computer software, management consultancy etc. Large firms have considerable advantage in providing a package of professional services. However, many specialized firms in specific sectors may also prove to be very competitive in view of the fact that they are able to access the delivery channel as comfortably as the large firms do.

In the case of professional services, despite the considerably varied nature of the services making up this category, there are several important commonalities. Firstly, India has considerable export potential in many of these activities due to its skilled, low-cost labour resources and demand-supply imbalances in many developed countries resulting from demographic trends and rapid advances in technology. In some professional services, India has considerable export potential; exports are constrained by a variety of restrictions, including lack of recognitions of Indian qualifications, nationality and residency conditions, needs-based tests and commercial presence requirements in host markets. In addition to relying on its endowment of skilled labour, India also has the potential for cross-border exports of various IT-enabled professional services, such as back-office activities which include processing, billing, handling calls, medical and legal transcription, tele medicine, tele-education and a variety of on-line and outsourced services.

CLASSIFICATION OF PROFESSIONAL SERVICES

The WTO Secretariat has divided all services into twelve categories, covering business services, communication services, construction and engineering services, distribution services, education services, environment services, financial services, health services, tourism and travel services, recreation, cultural and sporting services, transportation services and other services.

The professional services covered under Business services, include legal services, Accounting, Auditing and Book keeping services, taxation services etc., but does not include all secretarial services. The services being rendered by Company Secretaries are therefore spreadover various sub-sector such as financial intermediation services and auxiliary services thereof, professional services and computer and related services. Their sub-classification description and explanation is given in following paragraph.

EXPLANATION TO SUB-CLASSIFICATIONS RELEVANT TO COMPANY SECRETARIES

(i) Subclass: 86119 - Legal advisory and representation services in judicial procedures concerning other fields of law

Explanatory note

Legal advisory and representation services during the litigation process, and drafting services of legal documentation in relation to law other than criminal law. Representation services generally consist of either acting as a prosecutor on behalf of the client, or defending the client from a prosecution. Included are both the pleading of a case in court, and out-of-court legal work. The latter comprises research and other work for the preparation of a case (e.g. researching legal documentation, interviewing witnesses, reviewing police and other reports), and the execution of post-litigation work, in relation to law other than criminal law.

(ii) Subclass: 86120 - Legal advisory and representation services in statutory procedures of quasi-judicial tribunals, boards etc.

Explanatory note

Legal advisory and representation services during the litigation process, and drafting services of legal documentation in relation to statutory procedures. Generally, this implies the representation of a client in front of a statutory body (e.g. an administrative tribunal). Included are both the pleading of a case in front of authorized bodies other than judicial courts, and the related legal work. The latter comprises research and other work for the preparation of a non-judicial case (e.g. researching legal documentation, interviewing witnesses, reviewing reports), and the execution of post-litigation work.

(iii) Subclass: 86130 - Legal documentation and certification services

Explanatory note

Preparation, drawing up and certification services of legal documents. The services generally comprise the provision of a number of related legal services including the provision of advice and the execution of various tasks necessary for the drawing up or certification of documents. Included are the drawing up of wills, marriage contracts, commercial contracts, business charters, etc.

(iv) Subclass: 86190 - Other legal advisory and information services

Explanatory note

Advisory services to clients related to their legal rights and obligations and providing information on legal matters not elsewhere classified. Services such as escrow services and estate settlement services are included.

(v) Subclass: 86211 - Financial auditing services

Explanatory note

Examination services of the accounting records and other supporting evidence of an organization for the purpose of expressing an opinion as to whether financial statements of the organization present fairly its position as at a given date and the results of its operations for the period ended on that date in accordance with generally accepted accounting principles.

(vi) Subclass: 86212 - Accounting review services

Explanatory note

Reviewing services of annual and interim financial statements and other accounting information. The scope of a review is less than that of an audit and therefore the level of assurance provided is lower.

(vii) Subclass: 86213 - Compilation of financial statements services

Explanatory note

Compilation services of financial statements from information provided by the client. No assurances regarding the accuracy of the resulting statements are provided. Preparation services of business tax returns, when provided as a bundle with the preparation of financial statements for a single fee, are classified here.

Exclusion: Business tax preparation services, when provided as separate services, are classified in subclass 86302 (Business tax preparation and review services).

(viii) Subclass: 86219 - Other accounting services

Explanatory note

Other accounting services such as attestations, valuations, preparation services of pro forma statements, etc.

(ix) Subclass: 81331 - Loan broking services

Explanatory note

Services of intermediaries between two or more parties engaged in offering and accepting loans.

(x) Subclass: 86220 - Book-keeping services, except tax returns

Explanatory note

Bookkeeping services consisting in classifying and recording business transactions in terms of money or some unit of measurement in the books of account.

Exclusion: Bookkeeping services related to tax returns are classified in subclass 86302 (Business tax preparation and review services).

(xi) Subclass: 86301 - Business tax planning and consulting services

Explanatory note

Advisory services to enterprises on how to arrange their affairs, with a view to minimizing the impact of income taxation on their profits by taking advantage of all allowances and benefits that the law provides.

Exclusion: Similar advisory services but including preparation or review services of various returns and reports for the client are classified in subclass

86302 (Business tax preparation and review services).

(xii) **Subclass: 86302 - Business tax preparation and review services**

Explanatory note

Services consisting in preparing or reviewing, for enterprises, various returns and reports required for compliance with the income tax laws and regulations and defending them if contested by the tax authorities. This may also include tax planning and control.

Exclusion: Advisory services on tax planning not including preparation or review services of returns and reports are classified in subclass/ 86301 (Business tax planning and consulting services).

(xiii) **Subclass: 86303 - Individual tax preparation and planning services**

Explanatory note

Services consisting in advising individuals on the means to minimize the impact of income tax on their revenues by taking advantage of all allowances and benefits that the law provides and/or preparing the returns and reports required for compliance with tax laws and regulations.

(xiv) **Subclass: 86309 - Other tax related services**

Explanatory note

Services consisting in assisting enterprises in tax planning and control other than income tax and preparing all documentation required by law.

(xv) **Subclass: 86401 - Market research services**

Explanatory note

Investigation services designed to secure information on the prospects and performance of an organization's products in the market. Included here are market analysis (size and other characteristics of a market) and analysis of consumer attitudes and preferences, which may utilize personal interviews, telephone and mail surveys, historical data, etc. Economic and social intelligence services not in connection with merchandised products, such as industry analysis, econometric modelling, demographic analysis, etc., are also included.

Exclusion: Public opinion polling services are classified in subclass/86402.

(xvi) **Subclass: 86402 - Public opinion polling services**

Explanatory note

Investigation services designed to secure information on public opinions regarding social, economic, political and other issues. Public opinion polling is typically done by telephone interviews but may also utilize personal interviews and mail surveys.

Exclusion: Similar investigation services designed to gather intelligence on consumer attitudes and preferences are classified in subclass 86401 (Market research services).

(xvii) **Subclass: 86501 - General management consulting services**

Explanatory note

Advisory, guidance and operational assistance services concerning business policy and strategy and the overall planning, structuring and control of an organization. More specifically, general management consulting assignments may deal with one or a combination of the following: policy formulation, determination of the organizational structure (decision-making system) that will most effectively meet the objectives of the organization, legal organization, strategic business plans, defining a management information system, development of management reports and controls, business turnaround plans, management audits, development of profit improvement programmes and other matters which are of particular interest to the higher management of an organization.

(xviii) **Subclass: 86502 - Financial management consulting services (except business tax)**

Explanatory note

Advisory, guidance and operational assistance services concerning decision areas which are financial in nature, such as working capital and liquidity management, determination of an appropriate capital structure, analysis of capital investment proposals, development of accounting systems and budgetary controls, business valuations prior to mergers and/or acquisitions, etc., but excluding advisory services on short-term portfolio management which are normally offered by financial intermediaries.

(xix) **Subclass: 86503 - Marketing management consulting services**

Explanatory note

Advisory, guidance and operational assistance services concerning the marketing strategy and marketing operation of an organization. Marketing consulting assignments may deal with one or a combination of the following: analysis and formulation of a marketing strategy, formulation of customer service and pricing policies, sales management and staff training, organization of distribution channels (sell to wholesalers or directly to retailers, direct mail, franchise, etc.), organization of the distribution process, package design and other matters related to the marketing strategy and operations of an organization.

(xx) **Subclass: 86504 - Human resources management consulting services**

Explanatory note

Advisory, guidance and operational assistance services concerning the human resources management of an organization. Human resources consulting assignments may deal with one or a combination of the following: audit of the personnel function, development of a human resource policy, human resource planning, recruitment procedures, motivation and remuneration strategies, human resource development, labour-management relations, absenteeism control, performance appraisal and other matters related to the personnel management function of an organization.

(xxi) **Subclass: 86505 - Production management consulting services**

Explanatory note

Advisory, guidance and operational assistance services concerning methods for improving productivity, reducing production costs and improving the quality of production. Production consulting assignments may deal with one or a combination of the following: effective utilization of materials in the production process, inventory management and control, quality control standards, time and motion studies, job and work methods, performance standards, safety standards, office management, planning and design and other matters related to production management, but excluding advisory services and design for plant layout and industrial processes which are normally offered by consulting engineering establishments.

(xxii) **Subclass: 86506 - Public relations services**

Explanatory note

Advisory, guidance and operational assistance services concerning methods to improve the image and relations of an organization or individual with the general public, government, voters, shareholders and others.

(xxiii) **Subclass: 86509 - Other management consulting services**

Explanatory note

Advisory, guidance and operational assistance services concerning other matters. These services include industrial development consulting services, tourism development consulting services, etc.

(xxiv) **Subclass: 86601 - Project management services other than for construction**

Explanatory note

Coordination and supervision services of resources in preparing, running and completing a project on behalf of the client. Project management services can involve budgeting, accounting and cost control, procurement, planning of timescales and other operating conditions, coordination of subcontractors' work, inspection and quality control, etc. These services consist only of management services; operating staff services are excluded.

Exclusions: Construction project management services are classified in class 8671 (Architectural services), 8672 (Engineering services) and, for turnkey projects, 8673 (Integrated engineering services).

(xxv) **Subclass: 86602 - Arbitration and conciliation services**

Explanatory note

Assistance services through arbitration or mediation for the settlement of a dispute between labour and management, between businesses or between individuals.

Exclusions: Representation services on behalf of one of the parties in the dispute and consulting services in the field of labour relations are classified in subclass 86190 (Other legal advisory and information services), 95110 (Services furnished by business and employers organizations) and 95200 (Services furnished by trade unions), respectively.

(xxvi) Subclass: 86609 - Other management services n.e.c.

Explanatory note

Management services, not elsewhere classified.

(xxvii) Subclass: 84210 - Systems and software consulting services

Explanatory note

Services of a general nature prior to the development of data processing systems and applications. It might be management services, project planning services, etc.

(xxviii) Subclass: 84220 - Systems analysis services

Explanatory note

Analysis services include analysis of the clients' needs, defining functional specification, and setting up the team. Also involved are project management, technical coordination and integration and definition of the systems architecture.

(xxix) Subclass: 84230 - Systems design services

Explanatory note

Design services include technical solutions, with respect to methodology, quality-assurance, choice of equipment software packages or new technologies, etc.

(xxx) Subclass: 87901 - Credit reporting services

Explanatory note

Services consisting in the reporting of credit ratings of persons and businesses. This involves the evaluation of the financial status and credit experience of prospective customers, loan applicants, etc.

(xxxi) Subclass: 87909 - Other business services n.e.c.

Explanatory note

Services generally provided to businesses, not elsewhere classified. Included here are business brokerage services, appraisal services other than for real estate, secretarial services, demonstration and exhibition services, etc.

(xxxii) Subclass: 81312 - Financial market regulatory services

Explanatory note

Monitoring and enforcement services of rules and regulations in the financial markets pertaining to deposit and loan services and respective institutions, and to securities markets and participants in those markets.

(xxxiii) Subclass: 81319 - Other financial market administration services

Explanatory note

Administrative services to security or commodity holders, brokers or dealers, e.g. security custody services, financial reporting services, and other market administration services, not elsewhere classified.

(xxxiv) Subclass: 81322 - Securities issue and registration services

Explanatory note

Administrative services related to the issue and registration of securities, e.g. provided in issuing stocks or bonds.

(xxxv) Subclass: 81329 - Other services related to securities markets

Explanatory note

Information services on stock quotations and information dissemination services through documents or electronic means. Other services related to securities markets, not elsewhere classified.

(xxxvi) Subclass: 81332 - Financial consultancy services

Explanatory note

Financial advisory services provided by financial advisers, mortgage advisers, bureaux de change, etc. to customers on financial matters, e.g. on Stock Exchange investment and personal financial planning.

Exclusions: Portfolio management services are classified in subclass/81323.

Advisory services on insurance and pension matters are classified in subclass 81402 (Insurance and pension consultancy services).

Advisory services on taxation matters are classified in class 8630 (Taxation services).

Financial management consulting services (except business tax) are classified in subclass 86502.

(xxxvii) Subclass: 81339 - Other services auxiliary to financial intermediation n.e.c.

Explanatory note

Other services auxiliary to financial intermediation, not elsewhere classified, e.g. services related to the implementation of monetary policy.

REFERENCES

1. Rupa Chanda, India and GATS 2000 : Negotiating Strategies and Domestic Reforms (ICRIER, September 2001).
2. Economic Survey, 2000-2001 & 2002-2003.
3. WTO Annual Report, 1999 & 2002.
4. WTO Negotiations on Trade in Services – FAQs (Ministry of Commerce & Industry, October 2002).
5. WTO Negotiations on Trade in Services – A Backgrounder (Ministry of Commerce & Industry).
6. Final Act Embodying the Results of the Uruguay Round of Multllateral Trade Negotiations (1994) 33 International Legal Materials, p. 1143 (1994).
7. Michael Blakency, "The origins of the World Trade Organisation", (1995) 2 International trade Law and Regulation, p. 49.
8. Focus : WTO Newsletter.
9. Doha Declaration adopted at the Fourth Ministerial Conference at Doha, Qatar.

PROFESSIONAL SERVICES UNDER GATS — AN OVERVIEW

YOGINDU KHAJURIA*

INTRODUCTION

Global business interest seeks binding, global and irreversible rules on services. Growth of multinational corporations expands and extends their global reach, increasingly to have a strong interest in reducing the cost of complying with the regulations they face in different countries. They also benefit by reducing competition from domestic, publicly owned firms and from the privatization and commercialization of public enterprises that allows them to expand their market share. Following of global rules to reduce or eliminate constraints placed by governments on their international commercial activity is understandably a key priority of many global corporations operating in the service sectors.

It is under these underpinnings and in view of growing share of services sector in international trade, the Uruguay Round included in the scope of multilateral trade negotiations services besides trade and IPRs.

Under Article XIX of GATS, further rounds of negotiations for progressive liberalization had been mandated to begin not later than 5 years from the date of establishment of WTO. Accordingly, negotiations have been commenced from January 1, 2000, which are still continuing and are scheduled to be completed by January, 2005 as decided in the Doha Ministerial Conference. The underlying principle of the services negotiations are contained in the Guidelines and Procedures for Negotiations on Trade in Services which member countries were required to finalise.

The General Agreement on Trade in Services (i.e., GATS) is the first multilateral agreement in trade whose main objective is the progressive liberalization of trade in services. This is a multi flanking structured agreement which restricts governmental actions affecting services through legally enforceable constraints backed up by trade sanctions. The GATS is one of the numerous agreements that were adopted in 1994 as part of the World Trade Organisation regime and apply to all WTO members. Extensive negotiations were formally launched in February 25, 2000 in Geneva to augment the original GATS framework and to transform it into a comprehensive commercial agreement.

This agreement was entered with a view to acridite the flow of international services and create a credible and dependable system of international trade rules under which all member countries will be treated at par on principles of non-discrimination.

The GATS is a remarkably ambitious agreement. It emphases on the establishment of a multilateral framework of principles and rules for trading in services under conditions of transparency and progressive liberalization and is a means of growth of all trading partners and the development of developing countries.

GATS gives due recognition to the Members rights to regulate the supply of services in pursuit of their own national policy objectives. It also establishes a framework of rules to ensure that Members administer their services regulations in a manner which is reasonable, objective and impartial and does not constitute unnecessary barriers to trade.The Doha Ministerial Declaration reaffirms the right of members to regulate and to introduce new regulations on the supply of services.

SCOPE AND COVERAGE

GATS covers all internationally traded services except services provided to the public in the exercise of governmental authority and in the air transport sector, traffic rights and all services directly related to the exercise of traffic rights. The WTO Secretariat has divided all services into twelve sectors which are further divided into 161 Sub-sectors.

Government is free to pursue any national policy objectives provided the relevant measures are in

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

conformity with GATS. It allows the members in specified circumstances to take and maintain measures in contravention of their obligations which includes :

(i) measures in reaction to serious balance of payments and external financial difficulties;

(ii) measures necessary to protect public morals or human, animal or plant life or health; and

(iii) measures necessary to secure compliance with laws or regulations not inconsistent with the agreement including among other measures necessary to prevent deceptive or fraudulent practices;

(iv) measures for prudential reasons, including the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier or to ensure the integrity and stability of the financial system.

GATS framework has been constituted into six parts and annexes. Part-I and II provides for scope and definition, Part III and IV lays the specific commitments and progressive liberalisation and Part V and VI lays down the Institutional and Final Provisions. These parts are followed by a series of Annexes on exemption from Most Favoured Nation Treatment, Movement of natural persons supplying services under the agreement, Air-Transport Services, Financial Services, Negotiations on Maritime Transport Services, telecommunications and negotiations on Basic Telecommunications.

OBLIGATIONS

GATS follows a positive approach under which each member is expected to undertake specific liberalisation commitments through a process known as scheduling wherein each member identifies the service sectors/sub-sectors and modes of supply in which it is willing to make commitments. Thereafter they inscribes the conditions under which they shall allow services and service suppliers access to its market by indicating limitations it wishes to place on market access and national treatment while granting access.

There are also some GATS obligations which apply to all service sectors. Obligations under GATS have been categorized into two groups. One dealing with General Obligations applying directly and automatically to all Member Countries of the WTO irrespective of the commitment made for each sector and other are the conditional obligations applying to member countries who have assumed market access and national treatment obligations.

General Obligations

The following falls within the ambit of general obligations :

(i) Most Favoured Nation Treatment i.e., favour one, favour all. As per GATS if a country allows foreign competition in a sector, equal opportunity in that sector shall be given to service providers from all other WTO Members. This treatment is applicable to all services subject to certain temporary exemptions.

(ii) Transparency requires that Member Countries shall publish all measures of general application and establish national enquiry points to respond to other member's information requests.

(iii) Other unconditional obligations includes the establishment of administrative review and appeals, procedures and disciplines on the operation of monopolies and exclusive suppliers.

CONDITIONAL OBLIGATIONS

Conditional obligations of GATS are Market Access and National Treatment.

Market Access

Market access is a commitment undertaken by individual members in specified sectors after negotiations. It may be subject to one or more limitations.

National Treatment

National treatment means equal treatment to one's own nationals and foreigners. In the context of services, it means that once a foreign company has been allowed to supply a service in one's country there should be no discrimination between the foreign and local companies.

The GATS had played a pivotal role in several recent WTO cases. The rulings in these cases laid that the "services" agreement can be used to challenge an almost unlimited range of regulatory measures that, even indirectly or unintentionally, affect the conditions of competition of international service suppliers.

MODES OF SUPPLY OF SERVICES

Applicability of GATS extends to all service sectors with an exception to services supplied in the exercise of governmental authority, these being services supplied neither on a commercial basis nor in competition with other suppliers. Flexibility to each member country has been given under GATS to decide the service sectors in which it will undertake and schedule commitments.

Such commitments are specified by the following modes of supply :

Mode 1 : Cross-border trade

Mode 2 : Consumption abroad

Mode 3 : Commercial presence

Mode 4 : Presence of natural persons.

Mode 1: Cross-border trade

Cross-border trade implies flow of services from the territory of one member country into the territory of another member country crossing the customs frontiers without hindrances through communications. For instance, an architect can send his architectural plan through electronic means or a doctor or a consultant can send his advise through electronic means.

Mode 2: Consumption abroad

Consumption abroad refers to instances when consumer of one member country goes to another member country to obtain services. Example of this kind is getting medical treatment or obtaining higher education abroad or a tourist using hotel or restaurant services abroad.

Mode 3: Commercial presence

Commercial presence can be established when a supplier of one member country roots a territorial presence in another member countries' territory to provide service(s). In this case, the service supplier establishes a legal presence in the form of a joint venture/subsidy/representative/setting up branch offices or agencies for rendering services.

Mode 4: Presence or movement of natural persons

Presence of natural persons refers to export of manpower. It engages admitting of foreign nationals to another member country in order to provide services e.g. doctors, engineers, individual consultants, accountants, software professionals etc.

However, GATS coverage extends to only temporary movement and not citizenship, residence or employment on a permanent basis in the foreign country.

The sectors and modes of supply of particular interest in India is the movement of natural persons. Our country has a large number of well-qualified professionals in service sectors. For example, Information Technology, Consultancy, Health, Engineering, Chartered Accountants, Company Secretaries, Financial Services etc.

Such services can be rendered either personally or electronically. In order to promote liberalization in above areas, India has submitted a proposal at the special session of the Council for Trade in Services on Liberalisation of Movement of Professionals.

ADVANTAGES OF LIBERALISATION OF TRADE IN SERVICES

The advantages emanating from liberalisation of trade in services may include :

(a) benefit of globalisation;

(b) improved economic efficiency;

(c) contribution towards creation of jobs;

(d) higher incomes;

(e) more options for consumers;

(f) better quality of life;

(g) lower cost services;

(h) source of revenue;

(i) encouragement to rapid expansion of foreign direct investment;

(j) effective integration of national economies;

(k) effort to reduce and eliminate disparity among countries etc.

PROFESSIONAL SERVICES

The beginning of GATS expressed a democrated desire to facilitate the increasing participation by countries globally towards trading in services by expanding their scope. This could be done properly by strengthening their domestic capacity, increasing efficiency and competitiveness. Professional services though having similar characteristics has wide range of areas and activities. They involve rendering of expertise in the respective fields. A mixture of activities like, accounts, taxation, Finance, Legal etc. require specific knowledge & skills.

Professional aptness of an individual is defined by the formal educational qualifications and by the quality of experience including upto date knowledge over the working span. Persons at the upper skill range in any occupation or group are recognised as professional persons and their occupations are referred to as professions. Examples of such professions are—Doctors, Engineers, Scientists, Architects, Lawyers, Chartered Accountants, Company Secretaries etc.

While interacting with a professional person one generally comes across two features :

— Level of expertise
— Manner of Professional work conducted.

The impact of these features in a transaction may be felt by individuals or small groups as in the case of doctors, lawyers etc. handling individual or family problems while, professionals handling matters of wider coverage.

Services have been extensively defined, as a human activity aide to satisfy a human need and does not constitute a tangible commodity. In a country like India there is considerable export potential in many of these activities due to its skilled, low-cost labour resources and demand-supply imbalances as a result from demographic trends and rapid technology advancements. However, in certain professional services, India has commendable export potential.

POSITION OF COMPANY SECRETARIES

The profession of Company Secretaries which made a humble beginning in the sixties has now come of age. With profound knowledge, expertise and sharp management skills, they have reached the higher echelons of management hierarchy, making a niche for themselves.

The clear and blended knowledge of various laws, taxation, finance, computers and corporate governance that they possess have made them versatile professionals capable of rendering wide range of services in diversified fields.

Company Secretaries apart from embarking upon, traditional areas of practice are increasingly being called upon to advise and provide guidance on legal aspects of business like—production, marketing and sales, administration etc. for identifying multifarious opportunities, issuing of due diligence certificates, arranging foreign collaborations, joint ventures, amalgamations, merger etc. within and outside India.

REFERENCES

1. WTO Negotiations on Trade in Services published by Ministry of Commence and Industry, Government of India, October, 2002.
2. Rupa Chanda, India and GATS 2000—Negotiating Strategies and Domestic Reforms published by Indian Council for Research on International Economic Relations, September 2001.
3. Text of General Agreement on Trade in Services (GATS)
4. Consultation Document on WTO Negotiations under GATS—Issued by Department of Commerce (Trading Policy Division), Ministry of Commerce and Industry, Government of India.
5. WTO and International Trade—M.B. Rao & Manjula Guru
6. The General Agreement on Trade in Services February 27, 2002, New Orleans, Louisiana
7. Referencer on WTO and GATS—'ICSI' Publication.

BUSINESS ETHICS, PROFESSIONALISM AND CORPORATE GOVERNANCE

V P SHARMA* & M A JOSEPH**

INTRODUCTION

Business ethics, professionalism and Corporate Governance are the important imperatives for survival and growth of a modern business organization confronted with multiple challenges including financial scams, dying sentiments of investors, fixing accountability, transparency, independence in decision making, rule of law, fairness in deals, etc. from the different stakeholders, i.e., investors, creditors, industry, government and society, in the present knowledge based, global and competitive environment.

In the years to come, not only corporate governance is going to be the major concern of management but also the basic ingredient of corporate governance is going to change. In addition to full disclosure of the workings of the company, a professional and good management has to identify and quantify the risk being undertaken by various stakeholders. And then the management has to apply all its innovative qualities to ensure that the risk for each stakeholder is reduced to an accepted level and that each stakeholder is rewarded properly for the risk undertaken by him. The success of any company would largely depend on maintaining a business model wherein all the stakeholders are made comfortable. Being transparent in all the dealings/workings can further enhance the comfort level of the stakeholders.

A key element of good governance—corporate or otherwise—is transparency projected through a code of good governance which incorporates a system of checks and balances between key players—boards, management, auditors and shareholders. Transparency in turn requires the enforcement of the right to information and the nature, timeliness and the integrity of the information produced at each level of interface defines the real issue. All of this can only succeeds if the responsibilities of each entity and their interface is defined with great clarity and understood by all.

For effective corporate governance, a company must symbolize harmonious alignment of various interests of individual, corporation and society. In yet another perspective, corporate reputation, competitive credibility and governance have become increasingly inter-oven. Therefore, corporate governance must be driven by ethical and philosophical concerns as well as legal structural imperative. In short, promoting corporate fairness, transparency and accountability are the hallmark for corporate governance.

Good governance is a source of competitive advantage and critical to economic and social progress. In an increasingly globalised economy, companies need to tap domestic and international capital markets for investment. However, investors, institutions and individuals alike, have choice—and the quality of corporate governance is increasingly becoming a criterion for investment and lending.

BUSINESS ETHICS

The term ethics has many nuances. Webster's Dictionary, defines "ethics" as relating to what is good or bad, and having to do with moral duty and obligation. Taylor defined ethics as "inquiry into the nature and grounds of morality where the term morality is taken to mean moral judgments, standards and rules of conduct".

The American Heritage Dictionary offers several definitions of ethics, including the study of the general nature of morals and of the specific moral choices to be made by an individual in his or her relationship with others, and the rules or stands governing the conduct of the members of a profession. However, ethics indicates an obligation to consider not only our own

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

personal well-being, but also that of others and of human society as a whole.

According to Carter McNamara in his "Complete Guide To Ethics Management" ethics itself requires learning the difference between what is right and what is wrong and taking that one step further and doing the right thing. The difficulty comes about in the first stage of categorizing a "right choice" and a "wrong choice"– the choices are not always obvious. Overall, ethics are the basic ground rules we use to live our lives.

Ethics in general is concerned with actions and practices that are directed to improving the welfare of people. Ethicists explore the concepts and language that are used to direct such actions and practices to improve human welfare. Thus, ethics deals with questions that relate to making a life worth living and helping people to achieve such a life. Ethics is largely a matter of perspective, putting every activity and goal in its place, knowing what is worth doing and not worth wanting and having.

Business ethics is a subset of the study of ethics in general. However, some special aspects must be considered when applying ethics to business. First, businesses must make a profit. Second, businesses must balance their desires for profit against the needs and desires of society. Maintaining this balance often requires compromise or tradeoffs. To address these unique aspects of the business world, society has developed rules-both legal and implicit-to guide businesses in their efforts to earn profits in ways that do not harm individuals or society as whole.

Most definitions of business ethics relate to rules, standards, and moral principles as to what is right or wrong in specific situations. Business ethics comprises moral principles and standards that guide behavior in the world of business. The public as embodied in the mass media, interest groups, and business organizations, as well as through individuals' personal morals and values, often determines whether a specific behavior is right or wrong, ethical or unethical. Although these groups are not necessarily "right," their judgements influence society's acceptance or rejection of business and their activities.

Business ethics can help individuals to recognize and resolve ethical conflicts within themselves with others, and with their environment so as to keep business management forever.

Obligations of a Business

While there is no denying the fact that business is an economic performance, it is also true that business is an organ of society and as such it must justify its continuance by fulfilling its role and responsibilities to society. One may even go to the extent of asserting that a business enterprise is a trust of the community which must discharge its obligations towards the various sections of the community. Some of the major obligations of business may be the following :

— **The enterprise and the shareholders** : In the first place, corporate business must provide a fair return on capital to shareholders and must provide them with regular, accurate and full information about the working of the enterprise. The shareholders should also meet their obligations by evincing keen interest in company affairs.

— **The enterprise and the workers** : It is the responsibility of the management to provide opportunities to the workers for meaningful work. Also, the management of a business should try to win the cooperation of the workers by creating the right conditions in the enterprise. The business enterprises owes it to the workers to provide recognition to the workers' union, accept the workers' right to associate and to help them to develop their own leadership in the unions through education. Social security, profit sharing, fair promotions, proper grievance settlement and employee welfare are some of the other well recognized responsibilities of business firms to their employees.

— **The enterprise and the consumers** : A business enterprise has the responsibility of providing the goods and other services needed by the community at the most reasonable possible prices. It must guard against adulteration, poor quality, lack of service and courtesy to customers, misleading and dishonest advertising, etc. The consumers also need protection against monopoly and restrictive trade practices. Such protection can be provided best if business learns to play its part with fairness and liberalism.

— **The enterprise and the community** : An enterprise must respect the law and pay taxes regularly and honestly. It must behave as a good citizen and take care to avoid bad effluents, smoky chimneys, ugly buildings, and devote attention to housing and workers' living conditions. It has the responsibility of maintaining proper relations with the community through the press and its meetings.

Code of Ethics

Due to increase in knowledge about the benefits of business ethics, many corporations have established a code of ethics. This code defines the values desired within the company and the ethical action demanded of its employees.

It is in the best interest of every organization to establish, on its own, an ethical code of conduct. Not only does the government reward organisations who do this, organisations are then able to personalize the code. The best option for an organisation is to develop an overall code of ethics for the company and then a separate code to guide each department. It is important to incorporate ideas from each division of the company and not just human resources and the legal department.

In order to put together a successful code of ethics, McNamara has offered several guidelines as under :

- Review laws and regulations to which the organisation must adhere. This ensures that the organisation will not be directly violating any laws.
- Identify each department and three or four traits that are representative of a highly ethical organization.
- Review information from the company's SWOT analysis. Identify what behaviors are necessary in building on the strengths, supporting weaknesses, taking advantage of opportunities, and protecting against threats.
- Consider ethical values that stakeholders may think are important. It is important to consider suppliers, shareholders, members of the local community, employees, clients/customers, etc. because the code of ethics will affect each of them as well.
- From the above steps, determine the five to ten ethical values most important to the organization. For example :
  - Trustworthiness: honesty, integrity, promise-keeping, loyalty
  - Respect: autonomy, privacy, dignity, courtesy, tolerance, acceptance
  - Responsibility: accountability, pursuit of excellence
  - Caring: compassion, consideration, giving, sharing, kindness, loving
  - Justice and fairness: procedural fairness, impartiality, consistency, equity, equality, due process
  - Civic virtue and citizenship: law abiding, community service, protection of the environment.
- Compose the code of ethics. In this step, it is important to associate with each value two examples of behaviors that reflect the value. Include in this step wording that tells employees they are expected to abide by the code. Make clear the consequences that will result if the code is not followed. Also include information letting them know whom they can talk to about any questions they have.
- The key members of the organization may review the code and give their input. Stress that their input is very helpful and encourage them to provide as much feedback as possible.
- Distribute the code of ethics to each employee and post it throughout the facility.
- After the code has been finalized and distributed, review it at least once each year and make any necessary revisions. This process will modernize and familiarize individuals with the codes and also remind them of the importance of each value and expected behavior. Reviewing the code each year will also help keep communication lines open.

PROFESSIONALISM

Everyone wants to become a "professional" these days or to work in a professionally managed organisation. While being professional may be a virtue, what exactly is implied by being a professional is often found lacking in individuals and companies. In fact, some family owned companies have higher professional standards than our so-called professionally managed companies.

Among the meanings of the word 'professional' in the dictionary, there are two aspects which are connected with the way we work. One is something that is related to a job or profession. The other means well-trained, or a person who is good at one's work. To be a professional, therefore, implies that a person is good in his job and can be depended upon. Clearly, it is easy to be a professional in the first sense. If we do anything over and over again in our lives, we become professionals of some sort. The second implication, however, is more difficult. It is easy to do a job, but to do it well as if our heart was in it, there lies the catch. Most of us are content in 'making do', or finishing the task at hand with the least amount of effort. We are not interested in putting our best effort because we think that the job is too small or too meaningless or that nobody is going to appreciate it.

The major characteristics of a professional may be summarized as under :

— The professional has skills or expertise proceeding from a broad knowledge base.

— The professional provides a service based on a special relationship with those whom he or she serves. This relationship involves a special attitude of beneficence tempered with integrity. This includes fairness, honesty and a bond based on legal and ethical rights and duties authorised by the professional institution and legalised by public esteem.

— To the extent that the public recognises the authority of the professional, he or she has the social function of speaking out on broad matters of public policy and justice, going beyond duties to specific clients.

— In order to discharge these functions, professionals must be independent of the influence of the State or commerce.

— The professional should be educated rather than trained. This means having a wide cognitive perspective, seeing the place of his or her skills within that perspective and continuing to develop this knowledge and skills within a frame work of values.

— A professional should have legitimised authority. If a profession is to have credibility in the eyes of the general public, it must be widely recognised as independent, disciplined by its professional association, actively expanding its knowledge base and concerned with the education of its members. If it is widely recognised as satisfying these conditions, then it will possess moral as well as legal legitimacy, and its pronouncements will be listened to with respect.

In nutshell the attributes of professional values include the following :

— Confidence

— Service

— Confidentiality

— Competence

— Contract

— Community

— Care

— Commitment

Being a professional means more than simply acquiring a degree. It means being true to your chosen profession and trying to excel in any job assigned to you. Sometimes it means simply doing what is right.

How to be professional

How does one become professional ? If we break up our tasks no matter what our area of work, we can probably come to the following sub-tasks:

— **Planning** : Professional behaviour demands a certain amount of planning so that overruns are avoided and the work proceeds smoothly. How many of us make plans in our everyday lives? How many companies take planning seriously? If we answer these questions, we may discover that many of us are not professional at all, even while claiming to be so.

— **Decision-making** : The way we make our decisions also shows how professional we are. Usually, we go by our whims and intuition and fail to analyse the situation. When we look around ourselves, we find the consequences of such decisions. Companies, which had diversified without taking into account ground realities have come to grief: a pharmaceutical company which entered the cosmetics industry, an engineering company which diversified into shipping, and so on. Certain multinational companies too made this mistake and entered in our country thinking that they could sell overpriced products to our huge middle class, but only come to grief. There were few buyers for their products showing that their decisions had been made out of wishful thinking rather than scientific principles.

— **Communication** : How we communicate also shows how professional we are. Do we take care to explain something to our customers, subordinates or superiors ?

— **Doing our job** : Our attitude gets reflected in the job that we do. Does it reflect our care and ability? Or are we content in doing a half-baked job hoping that someone else will correct our mistakes? A journalist can give a story full of mistakes and these will no doubt be corrected at the proofing stage. But professionalism demands that all mistakes are removed by the person himself, without depending on anyone else. It also means keeping an eye for details, however minute they may be.

— **Doing what is right** : A company which does not treat its workers well can hardly be called professional, no matter how many professionally qualified people it employs. Similarly, companies, which do not pay taxes or fail to take note of their social responsibility, are unprofessional. Unfortunately, most of us want to be 'yes-men', accepting orders from above which may or may not be right. The moment we do something, which we believe is wrong, we are not professional, no matter how many degrees we may have.

CORPORATE GOVERNANCE

Corporate governance has gained importance in the recent times. "The need for greater transparency in corporate functioning, in the board room practices, in accounting procedures and for broader concern for all stakeholders have been highlighted in a series of reports of expert Committees the world over. The subject has assumed sharper focus with the unpleasant experiences of the more recent corporate collapses, precipitated by the failure of the human factors in financial, managerial and audit supervision. These developments shook the foundation of the corporate credibility. Corporate leaders, Government and regulatory authorities are now seriously concerned with remedial steps which 'while not dampening the corporate enterprises' will at the same time, ensure transparency and openness". (*M N Venkatachaliah - Former Chief Justice of India*).

Basically, corporate governance is the mechanism by which the values, principles, management policies and procedures of an organisation are made manifest in the real world. The great quintessential elements of corporate governance are transparency, accountability and integrity. Today, almost every country has institutionalized a set of corporate governance codes, spelt out best practices and has sought to impose appropriate board structures. Despite the 'corporate governance revolution', there exist no universal benchmark for effective level of disclosure and transparency. At a juncture, when the concept of corporate governance is receiving unprecedented attention, it is ironic if not disturbing that recent collapses in corporate arena have been primarily on account of corporate governance failures.

Thus, issue of corporate governance was described by our Prime Minister Shri Atal Behari Vajpayee, "International business experiences over the past few years, has clearly brought in lime light. Issue still could'nt get an appropriate and conclusive answer. Numerous debates, discussions, discources and documentations, have broadly projected corporate governance as a multifaceted as well multi disciplinary phenomena. And it involves board of directors, shareholders, stakeholders, customers, employees and society at large. To built up, an environment of trust and confidence amongst all the components, though having competing as well conflicting interests is a celebrated manifesto of the Corporate Governance. On a tree, one may visualize fruits of more than one variety. And he may find himself in Wonderland".

Contemporary Review of trends in Corporate Governance

In developed countries, like USA and UK, good governance aims at ways in which the strong outside shareholders and stakeholders can influence the behaviour of the inside management. The best international practices on the corporate governance given by the committees like Cadbury, Greenbury, Hampel and the Blue Ribbon exemplify these objectives.

United States of America

In USA, the major focus of good corporate governance is on shareholder 'rights'. However, more recent disclosures on treatment of stock options and certain post retirement arrangements of CEO's, at what is arguably the best managed and best performing corporations, indicate instances of CEO's greed and utter disrespect of stakeholders' interest. In fact, the impact of such operational risk is much deeper than that from other forms of risks. The spate of corporate misdemeanors has therefore cast some doubt on the efficiency and effectiveness of the board and auditors in USA. People have also started questioning the efficiency on the part of regulatory and supervisory agencies, accounting standards setting arrangements and other market participants such as investment bank analysts and rating agencies.

A close look at the number of authoritative accounting guidelines in USA shows that it has the most detailed disclosure requirements and it has produced many industry specific accounting standards and interpretation statements. As of now there are 141 Financial Accounting Standards (FAS) issued by the Financial Accounting Standards Board (FASB) as compared to 41 by International Accounting Standards Board (IASB). However, Mr. Harvey Pitt, until recently Chairman of

SEC has admitted that rule based accounting has got them nowhere. While the Blue Ribbon commission of the National Association of Corporate Directors has recently stated that: "it is difficult for us to see how an active chief executive officer, already responsible for the operations of the corporation, can give the time necessary to accept primary responsibility for the operations of the board".

Overall, the recent imbroglio in the corporate sector in USA has highlighted that only compliance with corporate governance requirements does not necessarily guarantee good financial reporting outcomes, if the individuals within it do not operate with the right degree of independence, with the right kind of expertise and do not devote the required amount of time to their important role. It has highlighted the need for self-discipline.

This has generated much debate and has led to legislative action in USA. At the 'regulatory and supervisory' level, the Sarbanes-Olexy Act of 2002, introduces radical changes in corporate accounting and governance. These include the creation of an 'Oversight Board' for the accounting industry, requiring the CEOs of large companies to swear an oath about the accuracy of the financial statements, introduction of criminal penalties for corporate fraud as well as increasing existing penalties, prohibition of external auditors from performing or consulting on other services such as the use of financial structures and audit partner rotation. The 'Oversight Board' will have authority to establish quality control and ethics standards to be used by auditors in the preparation of audit reports, conduct investigations and discipline auditors.

United Kingdom

In UK, the major focus of corporate governance is on board structure, processes and accountability. The board operates usually, though not always, with a majority of non-executive directors. They almost always separate the role of the chairman and the chief executive, certainly since the Cadbury review of corporate governance in early 1990s. The role of Audit Committees has been greatly enhanced, while 'internal audit' has traditionally been seen as complementary to the 'statutory audit' pursuant of the Companies Act 1985.

The UK has moved to a single unified regulatory body – the Financial Services Authority (FSA). Section 166, 340-346 of the Financial Services and Markets Act 2000 (FSMA 2000) states that the auditor is an integral part of the regulation and supervision of 'authorised persons'. In supervising the banks, among other things, FSA aims to protect depositors not the interests of shareholders. However, the bank shareholders will usually benefit from confidence in the banking system, which prudential supervision helps to maintain. Directors are required to certify explicitly that the company is a "going concern" and that all material disclosures have been made. There is a legal liability in relation to these disclosures. The FSA has also laid down "fit and proper" criteria for "approved persons". Directors in banks and financial institutions are treated as "approved persons" and rigorous "fit and proper" criteria have been prescribed.

In U.K., 'Qualification' of the financial accounts of a bank is not a simple decision. In such cases, auditors are required to notify the FSA, if they intend to qualify the accounts in accordance with sections 235 (2)(3) and 237 of the Companies Act, 1985. The bank would also have to consider, whether it should notify the FSA of a possible qualification of their annual financial statements, even if the 'qualification' is no more than a comment on an aspect of its accounts. Provision also exists to rotate the accounting partner (the lead partner).

Indian Experience

Corporate governance leads to corporate excellence, it must be structured according to the principles of Vedas, aligned with natural law.

In the Indian context, Corporate Governance can be drawn from the following age-old *'mulyas'* (values):

(a) *Lok Sangraham* — public good which means greatest possible good of all;

(b) *Dhanam* — creation of wealth through competence (kaushalam) and productivity (utpadakta);

(c) *Swatantra* — autonomy and independence, in business decisions;

(d) *Vishwastata* —trusteeship, implying that management is a trustee of stakeholders;

(e) *Dharm yudh* — fair battle, providing a level playing field to all and ensuring fair competition.

(f) *Vividhata* — variety or innovation ensuring flexibility in approach.

It is important to be genuine in purpose. Straight forward in execution and learn not to repeat mistakes. Corporate governance means being true to own belief and it constantly teaches the value of understanding the stakeholders. It builds enduring bonds with shareholders, employees, investors, depositors, borrowers, suppliers, customers and business constituents.

In developing countries like India, the major emphasis of Organisation of Economic Co-operative & Development (OECD) principles of corporate governance is on protection of shareholders' rights, protection of stakeholders' rights and timely and accurate disclosure on all material matters, including the ownership and governance. Regarding the protection of stakeholders' rights, the OECD principles emphasize that the corporate governance framework should assure that the rights of stakeholders that are protected by law are respected and stakeholders have the opportunity to obtain effective redress for violation of their rights.

In India, a small beginning was made by the Confederation of Indian Industry (CII) followed by the professional bodies like the Institute of Company Secretaries of India (ICSI) during the years 1996-97 to focus the attention of Indian corporate sector on the imperative need to evolve new norms of governance to sustain and develop Indian industry on healthy lines.

To promote and raise standards of corporate governance in respect of public listed Indian companies (including the banks), the Kumar Mangalam Birla Committee Report (clause 49 of the Listing Agreement) provides both mandatory and recommendatory ways, which include board structure, processes and disclosure on material matters. Regarding shareholders' rights, most of the suggestions of the committee are recommendatory in nature. While some more efforts are required to protect the stakeholders' rights.

The Government of India constituted Naresh Chandra Committee to look into various aspects of Auditor-company relationship and regulating auditors. The major aspects of terms of reference of the committee were (i) rotation of auditors/auditing partners, restrictions on non audit fee/work, procedures for appointment of auditors and determination of audit fees, etc. ; (ii) examine measures required to ensure that the management and auditors actually present the true and fair statement of the affairs of companies, such as personal certification by directors, random scrutiny of accounts etc.; (iii) examine if the present system of regulation of the profession of Chartered Accountants, Company Secretaries and Cost Accountants is sufficient and has served well the concerned stakeholders, especially the small investors and whether there is advantage in setting up an independent regulator and (iv) examine the role of independent directors, and how their independence and effectiveness can be ensured.

The Committee submitted its report to the Finance Minister on 23rd December 2002. In its report, the Committee has commended on the poor structure and composition of the Board of Directors of Indian companies, scant fiduciary responsibility, poor disclosures and transparency, inadequate accounting and auditing standards, the need for experts to go to the minutest details of transactions among companies, banks and financial institutions, capital markets, etc. The Committee observed that the performance of many companies with regard to the corporate governance standard is far from satisfactory. On the Auditor-Company relationship, the Committee recommended that the proprietary of auditors rendering non-audit services is a complex area which needs to be carefully dealt with. The recommendations are more or less in line with that of the Rules framed by SEC-USA in accordance with the provisions of Sarbanes-Olexy Act, 2002. Many of the recommendations of Naresh Chandra Committee have found room in the Companies Amendment Bill, 2003 pending the consent of the Parliament.

Securities and Exchange Board of India constituted a Committee under the Chairmanship of N R Narayana Murthy, Chairman and Mentor of Infosys Technologies Ltd. and mandated the said Committee to *inter alia* review the performance of corporate governance in India and made appropriate recommendations. The Narayana Murthy Committee submitted its report on 8th February, 2003. The Committee has confined its recommendations regarding the role of the Audit Committee to public listed companies, risk management, proceeds from initial public offerings (IPO's), code of conduct of the board, nominee directors and independent directors.

To promote a corporate philosophy and culture of credibility, transparency and ethical governance in Indian corporate sector, the ICSI has assumed leading role by instituting "ICSI National Award for Excellence in Corporate Governance". The award is annually conferred to the companies which adhere to the best corporate governance norms.

The ICSI has also prescribed the Secretarial Standards and issued Guidance Notes to rationalize various core activities of the companies such as conduct of the Board Meetings, Annual General Meetings, Declaration and Payment of Dividend etc. Some companies have already started following these standardised practices prescribed by the Institute. The Institute of Chartered Accountants of India has also prescribed the accounting standards for lending credibility to the financial statements and also evolved auditing practices to be followed by its members for effective conduct of audit. These initiatives augur well for implementation of Code of Corporate Governance in its true spirit.

Overall, in India, in a common man's language, "Corporate Governance came in as fashion, soon became fad and now is a passion".

A small poem is worth mentioning here which describes the state of corporate governance in typical Indian company which vanished after raising money from the public: -

"Where depositors are cheated and investors are decimated

Where profiteering is preferred and profitability is deferred

Where there is plenty of sycophancy and ethics are not even in the stage of infancy

Where employees are exploited and their dues are often forfeited

Where managers are neurotic and the management is despotic

Where an independent director is a management puppet who blows its trumpet."

Corporate Social Responsibility

Sometimes variety of terms are used for business ethics, such as, Corporate Social Responsibility (CSR), corporate citizenship, corporate accountability, sustainability. Corporate social responsibility means achieving commercial success in ways that honor ethical values and respect people, communities, and the natural environment. CSR in a sense means addressing the legal, ethical, commercial and other expectations the society has for business, and making decisions that fairly balance the claims of all key stakeholders.

CSR in narrow sense covers comprehensive set of policies, practices and programs that are integrated into business operations, supply chains, and decision-making processes throughout the company - wherever the company does business - and includes responsibility for current and past actions as well as future impacts. Its focus varies by business, by size, by sector and even by geographic region. CSR in broadest sense therefore, includes issues related to - business ethics, community investment, environment, governance, human rights, marketplace and workplace.

Evolution of CSR

The field of corporate social responsibility has grown exponentially in the last decade. More companies than ever before are engaged in serious efforts to define and integrate CSR into all aspects of their business, with their experiences being bolstered by a growing body of evidence that CSR has a positive impact on business economic performance. New voluntary CSR standards and performance measurement tools continue to proliferate amidst the ongoing debate about whether and how to formalize legal CSR requirements for companies. Stakeholders - including shareholders, creditors, analysts, regulators, activists, labor unions, employees, community organizations, and the news media - are asking companies to be accountable not only for their own performance but for the performance of their entire supply chain, and for an ever-changing set of CSR issues. All of this is taking place against the backdrop an ever more complex global economy with continuing economic, social and environmental inequities.

CSR to Business

Being ethical is an essential element in every corporation. Business ethics benefits the workplace by providing employees and management with a standard guideline and set of values expected within the firm. Being an ethical organisation will also provide relationships with consumers as a result of improving the organisation's public image. As an organisation, the main goal is to increase value for shareholders'. By improving relationships with consumers, profits will increase and therefore shareholder wealth will increase.

Significance of Corporate Social Responsibility to Business

The significance of CSR in a business in its multiple dimensions can be better understood in terms of following :

— **Better Financial Performance**: Business and investment communities have long debated whether there is a real connection between socially responsible business practices and positive financial performance. In the last decade an increasing number of studies have been conducted to examine this link. One of the more recent analyses - a 2002 DePaul University study - showed that overall financial performance of the 2001 Business Ethics Best Citizen companies was significantly better than that of the remaining companies in the S&P 500 Index, based on the 2001 Business Week ranking of total financial performance. The ranking was based on eight statistical criteria, including total return, sales growth, and profit growth over the one-year and three-year periods, as well as net profit margins and return on equity. The Best Citizens scored ten percentile points higher that the mean ranking of the remainder of the S&P 500 companies.

— **Reduction in Operating Costs** : CSR initiatives also reduce operating costs dramatically. For example, many initiatives aimed at improving environmental performance-such as reducing pollution that contribute to global climate change or reducing use of agrochemicals - also lower costs. Many recycling initiatives cut waste-disposal costs and generate income by selling recycled materials. In the human resources arena, flexible scheduling and other work-life programs that result in reduced absenteeism and increased retention of employees often save companies money through increased productivity and reduction of hiring and training costs.

— **Boost in Brand Image and Reputation**: Customers often are drawn to brands and companies with good reputations in CSR-related areas. A company considered socially responsible can benefit both from its enhanced reputation with the public as well as its reputation within the business community, increasing a company's ability to attract capital and trading partners.

— **Increased Sales and Customer Loyalty**: A number of studies have suggested a large and growing market for the products and services of companies perceived to be socially responsible. While businesses must first satisfy customers' key buying criteria - such as price, quality, availability, safety and convenience.

— **Higher Productivity and Quality** : Company efforts to improve working conditions, lessen environmental impacts or increase employee involvement in decision-making often lead to increased productivity and reduced error rate. For example, companies that improve working conditions and labour practices among their suppliers often experience a decrease in merchandise that is defective or can't be sold.

— **Attract and Retain Employees** : Companies perceived to have strong CSR commitments often find it easier to recruit and retain employees, resulting in a reduction in turnover and associated recruitment and training costs. Even in difficult labour markets, potential employees evaluate a company's CSR performance to determine whether it is the right "fit".

— **Reduced Regulatory Oversight** : Companies that demonstrably satisfy or go beyond regulatory compliance requirements are given more free reign by both national and local government entities. In U.S.A., for example, federal and state agencies overseeing environmental and workplace regulations have formal programs that recognize and reward companies that have taken proactive measures to reduce adverse environmental, health and safety impacts. In many cases, such companies are subject to fewer inspections and paperwork, and may be given preference or "fast-track" treatment when applying for operating permits, zoning variances or other forms of governmental permission.

— **Access to Capital** : The companies with strong CSR performance have increased access to capital that might not otherwise have been available. As per available information, 2001 report on socially responsible investing in the United States, the Social Investment Forum reported that social investing rose to $2.34 trillion despite an extended market downturn for most of the two-year period since the publication of the 1999 study. The primary driver for this growth was portfolios screened for socially concerned investors, which climbed 36 percent from $1.49 trillion in 1999 to $2.03 trillion in 2001. This amount accounts for nearly 12 percent of the $19.9 trillion in investment assets under professional management in the U.S.

Major Developments in CSR

Several factors have converged over the last decade to shape the direction of the CSR field. Some of the most notable ones include the following :

— **Increased Stakeholder Activism** : Corporate accounting scandals have focused attention more than ever on companies' commitment to ethical and socially responsible behavior. The public and various stakeholders have come to expect more of business. Increasingly, they are looking to the private sector to help with myriad complex and pressing social and economic issues. There is a growing ability and sophistication of activist groups to target corporations they perceive as not being socially responsible, through actions such as public demonstrations, public exposes, boycotts, shareholder resolutions, and even "denial of service" attacks on company websites.

— **Proliferation of Codes, Standards, Indicators and Guidelines** : New voluntary CSR standards and performance measurement tools continue to proliferate, adding to an already complex landscape. The recent U.S. accounting scandals have created another surge of standards development in an already crowded field.

— **Accountability Throughout the Value Chain** : Over the past several years, the CSR agenda has been characterized in large part by the expansion of boundaries of corporate accountability. Stakeholders increasingly hold companies accountable for the practices of their business partners throughout the entire value chain with special focus on supplier environmental, labour, and human rights practices. Additionally, company purchasing power is being viewed as a unique resource that contributes economic development investment capital, as well as facilitating basic trade of products and services.

— **Transparency and Reporting** : Companies are facing increased demands for transparency and growing expectations that they measure, report, and continuously improve their social, environmental and economic performance. Companies are expected to provide access to information on impacts of their operations, to engage stakeholders in meaningful dialogue about issues of concern that are relevant to either party and to be responsive to particular concerns not covered in standard reporting and communication practice. Leadership companies are also investigating various types of audit and verification as a further means of increasing the credibility of their transparency and reporting efforts. Increasingly, demands for greater transparency also encompass public policy; stakeholders want to know that the way companies use their ability to influence public policy is consistent with stated social and environmental goals. As part of this move towards greater disclosure, many companies are putting increasingly detailed information about their social and environmental performance - even when it may be negative - onto their publicly accessible websites.

— **Growing Government Interest and Action**: Europe is Leading the Way: In Europe, CSR has moved to a prominent place in both the business and policy agenda. A great deal of this activity has been catalyzed by the public sector. The European Commission has placed CSR at the core of Europe's competition strategy, and has issued a Green Paper on CSR and a subsequent communication outlining the Commission's definition of CSR and steps that companies, governments, and civil society can undertake to refine their commitments to CSR. This has led to the creation of a European Multi-Stakeholder Forum on CSR that will recommend to the Commission how to more fully embed CSR in policy and practice. National governments have also been active; requirements for social and environmental reporting have been established in France and considered in the UK, and Denmark has made efforts to promote cross-sectoral collaboration. European companies have also increased their commitment to CSR, and have participated prominently in the World Summit on Sustainable Development and the UN Global Compact, as well as individual company initiatives. Other initiatives are underway at least at a policy development level in South Africa, Brazil, and Argentina. The Organization for Economic Cooperation and Development (OECD) has done some work to convene member states and private and civil society stakeholders to discuss how it might do more to encourage member states to implement and enforce its Guidelines for Multinational Enterprises.

— **Convergence of CSR and Governance Agendas** : In the past several years, there has been a growing convergence of the corporate governance and CSR agendas. In the 1990s, the overlap was seen most clearly on issues such as board diversity, director independence, and executive compensation. More recently, an increasing number of corporate governance advocates have begun to view companies' management of a broad range of CSR issues as a fiduciary responsibility alongside traditional risk management. In addition, more and more CSR activists have begun to stress the importance of board and management accountability, governance, and decision-making structures as imperative to the effective institutionalization of CSR.

— **Growing Investor Pressure and Market-Based Incentives** : While religious and socially responsible investors have been pressuring companies on their social, economic, and environmental performance for the last 30 years, CSR is now more and more part of the mainstream investment scene. The last few years have seen the launch of several high-profile socially and/or environmentally screened market instruments (e.g., indexes like the Dow Jones Sustainability Indexes). This activity is a testament to the fact that mainstream investors increasingly view CSR as a strategic business issue. Many socially responsible investors are using the shareholder resolution process to pressure companies to change policies and increase disclosure on a wide range of CSR issues, including environmental responsibility, workplace policies, community involvement, human rights practices, ethical decision-making and corporate governance. Activist groups are also buying shares in targeted companies to give them access to annual meetings and the shareholder resolution process.

— **Advances in Information Technology** : The rapid growth of information technology has also served to sharpen the focus on the link between business and corporate social responsibility. Just as e-mail, mobile phones and the Internet speed the pace of change and facilitate the growth of business, they also speed the flow of information about a company's CSR record.

— **Pressure to Quantify CSR "Return on Investment"**: Ten years after companies began to think about CSR in its current form, companies, their employees and customers, NGOs, and public institutions increasingly expect returns on CSR investments, both for business and society. This is leading to questions about how meaningful present CSR practice is, and the answers to those questions will determine - in part - both the breadth and depth of CSR practice for the next decade. Companies want to determine what their CSR initiatives have accomplished so that they can focus scarce resources most effectively. Societal CSR advocates want to see demonstrable social and environmental improvements, while critics will continue to assert that CSR is just a fig leaf helping to preserve the status quo.

Implementation of CSR

Each company differs in how it implements corporate social responsibility. The differences depend on such factors as the company's size, sector, culture and the commitment of its leadership. Some companies focus on a single area - the environment, for example, or community economic development - while others aim to integrate a CSR vision into all aspects of their operations. Below are some key strategies that companies can use when implementing CSR policies and practices.

— **Mission, Vision and Values Statements**: If CSR is to be regarded as an integral part of business decision-making, it merits a prominent place in a company's core mission, vision and values documents. These are simple but important statements that succinctly state a company's goals and aspirations. They also provide insight into a company's values, culture and strategies for achieving its aims. The mission or vision of a socially responsible business frequently references a purpose beyond "making a profit" or "being the best," and specifies that it will engage in ethical and responsible businesses practices, and seek to make decision that balance the needs of key stakeholders, including shareholders/owners, employees, customers, suppliers communities and the natural environment.

— **Cultural Values** : Many companies now understand that corporate social responsibility cannot flourish in an environment where innovation and independent thinking are not welcome. In a similar vein, there must also be a commitment to close the gap between what the company says it stands for and the reality of its actual performance. Goals and aspirations should be ambitious, but care should be exercised so the company says what it means and means what it says.

— **Corporate Governance** : Many companies have established ethics and/or social responsibility committees of their boards to review strategic plans, assess progress and offer guidance about emerging CSR issues of importance. Some boards that do not have these committees have the full board consider issues of corporate social responsibility. In addition to having committees and boards, some companies have adopted guidelines governing their own policies and practices around such issues as board diversity, independence, terms, and compensation.

— **Management Structures** : The goal of a CSR management system is to integrate corporate responsibility concerns into a company's values, culture, operations and business decisions at all levels of the organization. Many companies have taken steps to create such a system by assigning responsibility to a committee of the board, an executive level committee or a single executive or group of executives who can identify key CSR issues and evaluate and develop a structure for long-term integration of social values throughout the organization. One important observation though is that there is no single universally accepted method for designing a CSR management structure. This is definitely not a "one-size-fits-all" exercise. What works for one company may not work for another, and *vice versa*. What does work, though, is following a process that allows you to design a structure that aligns your company's mission, size, sector, culture, business structure, geographic locations, risk areas and level of CSR commitment.

— **Strategic Planning** : A number of companies are beginning to incorporate CSR into their long-term planning processes, identifying specific goals and measures of progress or requiring CSR impact statements for any major company proposals.

— **General Accountability** : In some companies, in addition to the efforts to establish corporate and divisional social responsibility goals, there are similar attempts to address these issues in the job descriptions and performance objectives of as many managers and employees as possible. This helps everyone to understand how each person can contribute to the company's overall efforts to be more socially responsible.

— **Employee Recognition and Rewards** : Most companies understand that employees tend to engage in behavior that is recognized and rewarded and avoid behavior that is penalized. The system of recruiting, hiring, promoting, compensating and publicly honoring employees all can be designed to promote corporate social responsibility.

— **Communications, Education and Training**: Many companies now recognize that employees cannot be held accountable for responsible behavior if they are not aware of its importance and provided with the information and tools they need to act appropriately in carrying out their job requirements. These companies publicize the importance of corporate social responsibility internally, include it as a subject in management training programs, and provide managers and employees with decision-making processes that help them achieve responsible outcomes.

— **CSR Reporting** : Many companies have come to understand the value of assessing their social and environmental performance on a regular basis. Annual CSR reports can build trust with stakeholders and encourage internal efforts to comply with a company's CSR goals. The best reports demonstrate CEO and senior leadership support; provide verified performance data against social, environmental and economic performance indicators; share "good" and "bad" news; set goals for improvement; include stakeholder feedback; and many times are verified by outside auditors.

— **Use of Influence** : Some socially responsible companies recognize that they can play a leadership role in influencing the behavior of others, from business partners to industry colleagues to neighboring businesses. They understand that ultimately it is in everyone's best interests to have as many companies as possible honoring the requirements and expectations of corporate social responsibility.

CONCLUSION

Business ethics, professionalism and corporate governance are interlinked with one another. During a period of transition from a controlled to market driven economy, basic fundamental and philosophical and structural changes take place. Business ethics provides philosophical base, vision, mission of an organization, whereas corporate governance is a shared way of corporate functioning and not just a set of rules. It implies a wide acceptance within, of a code of governance, which is transparent and is perceived as such. Corporate action needs to conform to letter and spirit in which society allows corporates to function. Such a society as ours has plenty of rules and regulations, but its adherence to the rules that decides the issue. Our corporate bodies need to be perceived as adhering to established norms. Corporates have to be ultimately good corporate citizens. Professionalism helps the corporation to achieve its desired goal. It is being increasingly recognized that being a responsible corporate citizen is important in ensuring long-term success of a company. India's corporate sector has a new tryst with destiny. To face the formidable challenges of the future, the corporate sector has to be empowered with a new vision, dynamic mission and a new mandate to follow best practices of governance.

REFERENCES

1. Dr. Hsi-Chi Hsiao & Kung-Jen Chang—Business Ethics for Information Service Industry, Taiwan.
2. Corporate Governance and Business Ethics, AIMA, Excel Books, New Delhi.
3. Robert E Frederic : A Companion to Business Ethics : Blackwell Publishers, Massachusetts, USA
4. Dr. S P Narang, Internal Auditing-Role in Corporate Governance : Souvenir – Second ICSI National Award for Excellence in Corporate Governance, 2002—ICSI, New Delhi.
5. Sanjiv Agarwal—Corporate Excellence a Product of Good Corporate Governance; Souvenir — Second :ICSI National Award for Excellence in Corporate Governance, 2002, ICSI, Lodi Road, New Delhi.
6. Ashok A. Desai — Towards meaningful Corporate Governance : Chartered Secretary, August, 2003.
7. Madhu Sehgal — Good Corporate Governance Practices — Benchmarking for Indian Banks : Proceedings of the Bank Conference, 2002, Indian Banking : Managing Transformations.
8. D K Prahalda Rao—Emerging Trends in Corporate Governance : Chartered Secretary, August 2003
9. Amit K. Vyas — Corporate Governance in India—Much Celebrated but Hardly Implemented : Chartered Secretary, August 2003
10. A Ramanathan—Transparent Accountability and Corporate Governance, Chartered Secretary August, 2003.
11. Business for Special Responsibility — Magazine.
12. JulieAnn HuelsKoetter : Business Ethics and Determinant of Organisational Risk.
13. Raj Agarwal & Parag Diwan – Business Environment.
14. Corporate Governance Reporting — Model Formats, ICSI Publication.