



**THE INSTITUTE OF
Company Secretaries of India**

IN PURSUIT OF PROFESSIONAL EXCELLENCE

Statutory body under an Act of Parliament

e-CS NITOR



42nd National Convention of Company Secretaries Opening Plenary

Standing on the Dais from L to R : Shri Arun Kumar Khandelia, Chairman, EIRC of ICSI, Shri Ashok Pareek, Council Member, ICSI, Shri Vikas Y Khare, Vice-President, ICSI, Shri C R Choudhary, Member of Parliament, Shri Saugata Roy, Member of Parliament, Shri R Sridharan, President, ICSI, Shri R K Dubey, CMD, Canara Bank, Shri Anil Murarka, Past President and Council Member and Chairman, Convention Organising Sub-committee, ICSI, Shri M S Sahoo, Secretary, ICSI.

42nd National Convention of Company Secretaries
'CS - Change. Challenge. Opportunities'
21-22-23 August, 2014 at Science City, Kolkata





Message from President



Dear Member,

With pleasure, we are bringing out yet another Special Issue of **e-CS Nitor**, carrying technical papers circulated at the 42nd National Convention of Company Secretaries held on 21-22-23 August 2014 at Kolkata. In continuation of our objective that the members should not be deprived of the benefit to access to technical papers, circulated, especially in major programmes and keeping this in mind, we have pleasure in bringing out National Convention Special Issue of **e-CS Nitor**.

The inaugural session was curtain raiser to the technical sessions and the valedictory session provided a grand finale. Shri Saugata Roy, Hon'ble Member of Parliament was the Chief Guest and Shri C R Chaudhary, Hon'ble Member of Parliament, was the Guest of Honour and Shri R. K. Dubey, CMD, Canara Bank was the key note speaker at the Inaugural Session. At the Valedictory Session, Hon'ble Member of Parliament, Dr Udit Raj, Hon'ble Justice Nadira Patherya, Judge, Calcutta High Court, Poojayashri Swami Supranananda. RK Mission Institute of Culture, Shri H. M. Bangur, Director, Shree Cement Ltd, addressed the delegates. Dr. M. Veerappa Moily, Hon'ble Former Union Minister and Member of Parliament addressed at the Special Session and his address gave requisite thrust to the discussion at the technical sessions. At this convention, we have brought out as many as 15 research publications. Discussions, at the technical sessions, which were handled by some of the brilliant minds of the country, offering fantastic insights, highlighting perspectives, enriching understanding, awakening and social values. I am sure that our members will welcome the change and will also be catalyst of change and with resoluteness they will face the challenge. I am also equally sure that the changes to bring opportunities and our members keenly embrace the opportunities as well as they will create opportunities, yes, as professionals, we should not restrict ourselves merely hug the opportunities, rather we have to generate opportunities, as Francis Bacon said "**A wise man will make more opportunities than he finds**". I wish that let all of us be that wise men.

With regards

CS R Sridharan

President

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THEME PAPER

CS – CHANGE. CHALLENGE. OPPORTUNITY

SAURABH JAIN*

Growing global competition, evolving legislative framework, emerging regulatory regime, nurturing excellence, crafting the best practices, abiding by the professional code, growing stakeholders participation, enlarging technology sphere, raising standards of governance and increasing ethical concern, are some of the indicators of evolving new paradigm, which has to inspire professionals to adapt to the changes as well as to act as catalyst of changes and in the process, bring in creative ideas, imaginative approach and innovative practice to their respective body of knowledge and discipline.

Business Environment and Regulatory Changes

Business confidence in India has got a boost with the new government coming into power after the national elections, for it is believed to be strong-willed, stable and business-focused. With the political predictability in place, the Indian economy has shown the signs of optimism, the markets have started shaping up and the global expectations are upbeat. A clear mandated, strong-willed, stable and business oriented government is expected to bring about transparency in governance norms, resulting in confidence coming back into the economy.

Top most on the list of recent regulatory prescriptions is the enactment of the Companies Act, 2013. Concerns on the new company law are manifold.

The survivors will be those who are able to manage change, ensure compliance, and drive business growth in this challenging economic climate. Company Secretaries need to gear up to help corporates meet compliance challenges in a continuously evolving regulatory landscape. They need to impress upon corporate boards why meeting compliance mandates requires greater agility, with increased visibility and control over processes.

Market Challenges

Times have changed, stakeholder democracy is taking youthful strides. Global market penetration and inevitable technological advancement is obligating newer challenges. This is a period of renaissance for the professionals and the industry. Dynamism with innovative spirits and creative mind of the skillful professional shall be a distinct characteristic.

Henry Wadsworth Longfellow said, "The heights by great men, reached and kept, were not attained by sudden flight, But they, while their companions slept were toiling upward in the night:"

India today stands at the cusp of greatness- while there are many challenges ahead, there are also boundless opportunities. Instances of mis-governance largely demoralising the investor sentiments, at this economic juncture, there is need to be daring, intrinsically questioning and who can dream big and make sacrifices for the sake of economic good. The professionals who are committed to a good

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value system, who walk the talk in demonstrating their values and beliefs, need to push forward the agenda of good governance. Integrity guides light in the hours of darkness, confusion and self-doubt, and when faced with a moral dilemma. A value system builds confidence, provides peace of mind, and enhances energy and enthusiasm during trials and tribulations.

Governance Challenges

A company needs to achieve a business purpose which stakeholders can understand. It may be, in the case of a retail bank, to offer financial services suitable for its customers or, in the case of an energy company, to supply energy on a reliable and sustainable basis. Stakeholders including employees, customers, suppliers and lenders, as well as shareholders, all expect companies to achieve their business purpose. Serving its purpose effectively generally enables a company to generate continuing profits and value for shareholders. However, generating profits and shareholder value is not in itself a sufficient business purpose for a company.

The business purpose of a company needs to be clear internally and externally. The identity of a company becomes confusing where its business purpose is inconsistent, ambiguous or in conflict with other aspects of its corporate identity. At the same time, a business should not be so focused on a specific purpose that it ignores changes in its environment. Therefore, innovation and adaptability are essential for a business purpose to be viable.

Social norms set boundaries for what is acceptable as business culture and conduct within societies where a company operates. While social norms may be generally well understood, they can sometimes be poorly articulated, volatile and even appear extreme or biased. Companies may need to identify what is socially acceptable through public engagement and monitor expressions of popular opinion and trends surfaced in traditional and social media.

Media and public focus on certain topics or aspects of corporate conduct may last only for brief periods of time, but companies need to determine when to rise above short-lived social expectations and to take actions in the light of continually evolving social norms. Companies also need to recognise that different communities (e.g., the financial services sector or their particular business) develop their own norms, and these community level norms may be radically different from those prevalent in wider society in ways which suddenly become apparent when those communities are subject to external scrutiny.

Legal and regulatory requirements are made up of general external requirements (e.g., relating to employment, health and safety, anti-corruption and taxation) and private contractual and fiduciary obligations (e.g., relating to company pensions and debt covenants). Being based on law, these requirements are mostly public and understood by those to whom they are applicable. Breaches of these requirements may lead to formal sanctions such as prosecution, disciplinary actions, penalties, suspension of rights to trade and litigation as well as reputational damage.

Opportunities under Corporate Laws

The Companies Act, 2013 has catapulted the profession of Company Secretaries to newer heights. Relying on sturdy shoulders of governance professional; it signals a new age of governance. The dominant theme of Companies Act is self-regulation. The principal responsibility in this regard has been entrusted on the Company Secretary, who has been given a position in the corporate hierarchy. The recognition of Company Secretary as a Key Managerial Personnel along with the Chief Executive Officer/managing director/manager, whole-time director and Chief Financial Officer is ample testimony to the fact that Company Secretaries have arrived at being the key person in the company. It is really challenging, as it demands delivery of quality service.



Three most essential areas of work for the PCS under the Act include Pre- certification, Signing of Annual Return and Secretarial Audit, which are the fertilizer of trust and confidence for good governance to flourish. The practicing professional needs to understand the intricacies of client-stakeholder relationship and have extraordinary skills to ensure and protect the trust of the company yet uphold the interest of the stakeholders including the regulators. The professionals are required to demonstrate not only Intelligence Quotient (IQ) but also Emotional Quotient (EQ).

Company Secretaries are knowledge professionals who guide, advise the strategy makers of entities. A true professionals should be courageous enough to convey the red flags identified, in the way of functioning of business, which may relate to compliance of law, ethical conduct of business, sensitivity to environment/society etc. A true professional should convey the message to the management that correcting the processes and system by removing the unethical roots, if any that may give temporary gains to the business but would leave an irrecoverable permanent damage. The new Companies Act has created a service area where PCS can re-align the statutory structure of its client companies in consonance to new Companies Act.

The Companies Act, 2013 penalises the professionals for reporting fraudulently, certifying incorrectly and ignorantly. The penalty includes hefty fine, imprisonment at many a places both. The Ministry of Corporate Affairs is clearly expecting quality, genuine authentication, and actual verification of documents. Professionals need to mitigate their risk, verify all the documents, seek clarity, ensure proper conduct and report on true and factual findings.

Company Secretaries have to seize opportunities and achieve competitive breakthrough without crossing the boundaries of ethical and fair conduct. Section 143(12) of the Act, has empowered the professionals to approach the government directly in case of detection of occurrence of fraud in an organisation. Right approach will take to the right direction. The professionals need the learning bent and create innovative ways to transform knowledge convergence into a value delivery proposition.

It is not only pre-certification or Secretarial Audit, the new Act has opened up many other new areas like valuation, insolvency practitioners, etc. The profession of Company Secretaries will reach its pinnacle, when its members will be fully in demand by Corporate, not due to mandatory requirements but for their value added services in non-core areas.

Society and Economy

Companies are expected to acknowledge their responsibilities, provide information on how effectively they meet them and be answerable for their actions. Companies need to be responsive to expectations of those to whom they owe that accountability as their relationships are often long term.

These responsibilities are of fundamental importance for companies to operate successfully in **today's business environment, however challenging they may be. Being responsive to the full range of its responsibilities can help a company to be agile and adaptable to its environment and identify new opportunities on a sustainable basis.** If companies are conscious of these responsibilities and consider what they can do to meet them, they should be better at developing coherent responses and anticipating or even eliminating potential expectation gaps in a changing business environment, for example as social norms change.

Moreover, where companies are convinced of the importance of the full range of their responsibilities and attempt to meet them, legislators and regulators can focus on developing requirements that are proportionate to specific needs.



SHAREHOLDER PROTECTION LAWS, CORPORATE GOVERNANCE AND SHAREHOLDER ACTIVISM – AN ANALYSIS IN INDIAN CONTEXT

J. P. SHARMA* POOJA SHARMA*

1. Introduction

Shareholder Activism, also known as 'relationship investing' has emerged as an important ingredient in the contemporary corporate framework. It is one of the mechanisms in Corporate Governance. Shareholder Activism is primarily a process of dialogue between the company executives and the shareholders in order to influence the actions of the company. The process has served as a powerful mechanism to create the pressure on corporations and educate the public on often-ignored social, environmental, and labour issues and the ethical practices being followed by the corporation. Critics point out that sustainable business cannot be attained in the absence of shareholder activism. Anecdotal studies conducted in the area of shareholder activism also suggest that Corporate Governance is positively related to the concept of Shareholder Activism. In the contemporary corporate governance framework, the meaning of corporate governance is incomplete without shareholder activism. Corporate Governance, has found its prominence and acceptance in most countries of the world as, "It includes making necessary disclosures and decisions, complying with the law of the land, commitment towards conducting the business in ethical manner and being responsible towards its stakeholders". In other words, Corporate Governance may be defined as a set of processes, mechanisms, and practices adopted by a corporate for its functioning. Corporate Governance, as defined in the Cadbury Report 1992¹, is the system by which companies are managed and controlled. It means conducting the business in more just and fair manner aiming at bringing transparency and accountability into the functioning of the company.

2. Relevance of the Study

Corporations cannot exist in isolation. They are governed by the rules of the state. This implies that they should be governed in such a manner the law of the land prescribes. Therefore appropriate and effective law-making is most important tool to regulate a company's working. A strong legal framework ensures better shareholder protection as well as ensures a platform where shareholders can voice their concerns and expect a speedy, effective and harmonious resolution and a legal remedy to their problems. Weak and inadequate set of laws, on the other hand, would result in lack of interest of shareowners in confronting the managements who are not bound by proper laws rendering all the time, efforts and resources for making them accountable futile. Therefore, better shareholder protection laws are an essential for shareholder activism to sustain. The absence of adequate data on Shareholder Activism in India and the ignorance of the topic among the shareholders and corporations justify the need and relevance of the current study.

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We will discuss the legal framework of the two pioneer countries in the field of corporate governance-US and UK, specifically focusing on the investor protection measures, strengthening the case for the shareowners .We will then examine the scenario in India and try to draw parallels as to where India stands as compared the these developed countries in the backdrop of the recent passing of Companies Act, 2013 and discussing the road ahead.

3. The Conceptual Framework

Corporations are bound to abide by the rules and regulations framed by the state. The legal framework of the country determines the conduct of its residents and the business organizations. A business in order to do business must be aligned with the various legal frameworks that are within the jurisdiction of that relevant country. A corporate, being an artificial juristic person is governed by **the laws set by the country's constitution where it is registered. Every nation has a set of rules and regulation which defines the functioning of the corporate sector and this is usually form of certain acts, statutes and governing bodies thereby formed to provide a ground for them to do their business.** Corporate Governance on similar lines is a specialised domain of the legal framework catering specifically the governance standards of incorporation. This is because the Laws of the land are the superstructure on which the edifice of corporate governance is built. In our study, we identified following regulations governing the conduct of a corporate in any country:

The statutory laws passed in the parliament by statutory order; the regulatory bodies' setup under each of these laws supervising the adherence of the law including the committees appointed by the government for proper implementation and revision of the laws; and the codes prescribes by the formal and informal bodies in the business communities. This is then imbibed in the corporate governance framework of a company. Following section identifies each of the aspect mentioned above, in the light of investor protection showcasing the scope of shareholder activism in USA, U.K. and India.

4. Corporate Governance Framework of USA, UK and India

4.1 Corporate Governance Framework of USA

Experts in the field of Corporate Governance argue that U.S. model of Corporate Governance is basically on outsider model with some key characteristics including dispersed ownership, greater outsider participation in ownership rights and highly participative and transparent management of affairs.

The U. S. corporate governance system has gradually evolved in the last three decades. The first phase of evolvement was witnessed during 1980s to 2001. Prior to 1980s, the governance structure was highly insider dominated, with numerous instances of hostile takeovers affected the minority **shareowner's interest.**

But the unexpected Enron debacle (witnessed during October 2001) changed the corporate governance norms with increased frequency of no vote campaigns and shareholder proposals targeting some of the most fundamental norms of corporate governance such as CEO compensation issues and turnover, changes in governance structures among others.²

The United States holds the distinction in having a number of regulatory bodies for the protection and prevention of financial irregularities and frauds. The laws governing all the legal aspect



associated with financial irregularities and frauds are embedded in the various sections and articles of the Securities and Exchange Commission (SEC).

The Securities and Exchange Commission (SEC) is the prime authority for regulation of securities market in the U.S with an aim to protect the investors from any fraudulent transactions. It also monitors the takeovers taking place in the corporate arena. Rule 14a-8 of Securities and Exchange Commission Act³ 's proxy rules makes a company obligatory to include shareholder resolutions in the proxy materials subject to the conditions provided are fulfilled. This gives the investors to gather support for a proxy fight or organise a campaign against the legitimate concerns of shareholders such as change in governance structure or replacing a board member. Another ruling under SEC requires any individual or a group of shareholders to file 13d form if the stake exceeds 5% of the voting stock in a company to ward off any takeover threats. This in turn is an effective measure to protect minority owner's rights.

Sarbanes-Oxley Act, 2002

The immediate fallout of the Enron debacle spurred the unanimous passing of the Sarbanes Oxley Act (SOX) in 2002. The Act was primarily enacted in the wake of a series of high profile scandals.

The chief clauses of the Act are:

Section 301-Public Company Audit committee: This clause mandated the formation of the audit committee which would comprise of independent directors of the Board of Directors where the auditors of the company will be under the scrutiny of the committee and ensure integrity of the audit process.

Section 404- deliberates on the issue of the adequacy of internal control mechanisms of management over its financial reporting.

Section 806 provides for the protection of the whistleblowers which can affect the position of the financial statement from any kind of harassment or unwarranted behaviour. It also requires full documentation of the whistleblowers account of the malpractice reported.

Section 406 titles code of ethics for senior financial officers spells the ethical code of conduct to be adopted for the principal applicable to its principal financial officer and comptroller or principal accounting officer, or persons performing similar functions.

The U.S. has no single national, authoritative Corporate Governance Code⁴. This is attributable to the constitutional barriers to setting company law at the national level. The federal nature of the state and centre relations has prevented creation of a binding code on governance for the industry. Various organisations, however, workings for the interest protection of shareholders do prescribe guidelines for better guidance and standardisation of investor protection, for example CalPERS (Calpers Global Corporate Governance Principles, 1996) Other legislations such as Sarbanes-Oxley, and the recent Dodd-Frank Wall Street Reform and Consumer Protection Act are a new addition to the investor protection framework. The commercial proxy advisory firms have also played an influential role in setting standards especially in the absence of a national code.

In addition to the law prescribed in the Calpers Global Corporate Governance Principles, the SEC,⁵ and the Sarbanes-Oxley Act, a new act, Dodd-Frank Wall Street Reform and Consumer Protection Act⁵ was introduced in July 2010, in response to the global financial crisis which led to confrontation with



the realities of defective implementation of governance norms for their personal financial gains and belittling the sanctity of legal procedures. The Act safeguards and protects the investors by fixing fiduciary duty on the broker for ethical investment advice. The Act further entails the formation of the investor advisory committee for a better legal representation of investors which is worth noting. In addition to that, Business Round Table is an association of the Chief executive Officers of companies in the US representing a third of the total value of the US stock market. It comprises of companies with total revenues of \$16 trillion. This association has taken a leading role in better corporate governance norms amongst American business houses. It has played a pivotal role in underscoring and promoting the ethical conduct since 1978 by bringing forward noteworthy recommendations for desirable adoption at regular intervals. Its recent contribution is the initiative in showcasing the importance of Corporate Governance.

It has played a pivotal role in changing the ground rules for promoting ethical conduct since 1978 by publishing recommendations for desirable adoption at regular intervals. The recent trends/contributions in the initiatives are the principles of Corporate Governance. Amongst the nine commandments for promoting better governance it recognises the power of the large shareholders in incorporation and emphasises that proper information dissemination and regular dialogue is key to better shareholder engagements. It recommends interaction with the shareowners on formal and informal platforms and educating them about conscious use of their voting power in annual general meetings. Involvement of directors and interaction with investor groups is also endorsed by the association.

4.2 Corporate Governance Framework of U.K.

The developed part of the world, irrespective of the strict legal framework and governance structure has not been spared by the giant corporate debacles in the last few decades. The U.K. has had its share of corporate scandals which led to a number of measures which were taken as a remedy to protect the interest of the shareholders. The most important step in this direction was formation of the Cadbury Committee in the year 1992⁶. Few noteworthy recommendations included curbing the powers of board of directors, importance of non-executive directors, establishment of remuneration committee and audit committee. Based on these codes, a listing agreement was introduced at the London Stock Exchange encouraging the compliance by listed companies.

Greenbery (1995) Committee was also formed and made major recommendations making specific observations on the compensation committees and executive pay. The UNCTAD Guidance on Good Practices in Corporate Governance Disclosure, UK (2008)⁷ emphasised the importance of adequate financial disclosure and increased board- investor communication indicating that participation and voting rights are the most relevant corporate governance tools in the quest of investor protection.

Companies Act sets out the juridical pathway for shareholders can to claim their say into a company's functioning. Companies Act, 2006⁸ incorporates various clauses advocating shareowner's say on contentious issues. Section 303 -305 and 314 to 315 enables requisitioning for a meeting and introducing resolution in a meeting by required number of shareholders or voting rights so that contentious issues can be addressed by the board. Section 168 allows removal of a director by a simple majority in the shareholders meeting. Under various sections under the law proxies are allowed to vote by show of hands and in a poll. They can even demand poll. The law also provides for indirect investors known as 'who are not the registered shareholders but have a economic interest in



the firm. They have informational rights such as to receive documents, circular, notices annual reports etc. Section 260 provides for the right of bringing a derivative claim against any of the director of the company for any misconduct including breach of trust and neglect of duty. This section particularly empowers shareowners as it neither necessitates holding of specific number of shares to bring the civil action against director nor the time limit for which the suitor should have held the share before bringing the action upon the board. Section 994 of the Companies Act lays down the guidelines for the purpose of preventing actions unfairly prejudicial to the interests of the shareholders. It provides the legal remedy for those who are at default at the managerial levels including majority shareholders.

The Financial Services Act, 2012⁹ led to the formation of two regulatory authorities Financial Conduct Authority and Prudential Regulation Authority in UK. Financial Conduct Authority is statutory authority which is responsible for protection of shareholders for the securities traded on the London Stock Exchange.¹⁰ The firms need to get permission for the purpose of investment and including stock broking companies, fund management companies and insurance companies. It also looks in to the shareholders complaints on mergers and takeovers affecting their interest negatively.¹¹

It can be observed that UK has taken the leadership role as far as shareholder protection measures are concerned. US, due to the constitutional impediments, do not present a consolidated position to **tackle the problem on shareholder's safeguard on corporate governance issues. A unified approach by the shareholders** is one tool to delineate remote shareowners concerns. One interesting observation made by Black and Coffee¹² is that the reason shareholder coalition are less observed in American institutes as compared to UK because US as institutions cannot act jointly and quietly as preferred by British counterparts.

4.3 Corporate Governance Framework of India

India cannot remain isolated for long in the current globalized world. In view of the current developments in corporate governance framework and the legal acceptance of terminology like the shareholder activism mostly in the western countries like the US and the UK, India too has opened up **its door and reckoned the term shareholder activism in the recently amended Company's Act 2013.** Indeed, India has always amazed the world in terms of creativity, productivity, or acceptance of the new technology or policy framework, thereby invigorating the enforcement of new policy framework **at the earliest. Dr. APJ Abdul Kalam in his book, Turning Point writes, "what amazes the world perhaps is the sagacity and maturity of the Indian voters who have always tried to exercise their mandate conscientiously and have proved that as envisaged in our constitution, the people are sovereign and power flows from them". Underscoring the importance of the above sentence remarked by one of the greatest visionary of the contemporary India, the new concept of Shareholder Activism is contemplated to have a positive result among the Indian Corporations.**

Shareholder Activism is largely driven by the shareholding pattern in the corporate structure of a company. The shareholdings in most of the Indian giants is characterised by block holders. These block holders are majorly of three categories namely Promoters, Financial institutions and Corporate. Most businesses are family driven dominated by founder, his family and associates.¹³ Agency problem is identified as a major problem which is usually of the kind controlling vs. the non-controlling shareowners. Therefore it is generally observed that block holders are able to push their agenda hurting the interest of minority shareowners.



Legal Framework

The Companies Act lays down the boundaries for the functioning of corporate in India. It is a fundamental law which governs the behaviour of the firms. The Government in August 2013 passed **the new Company's Bill in Rajya Sabha** which has now replaced Companies Act 1956 as Companies Act, 2013. The Companies Act, 2013 includes the section 241 and 242 for Prevention of Oppression and Mismanagement which allows the investor to file a complaint against the company if the affairs of the company are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member or members (including any one or more of them). The provision of appointing a small shareholder director on the board also ensures adequate investors representation of interest (Section 151). The act also allows the members(holding one tenth of the voting rights or 100 members holding a paid-up capital of one lakh or more to file shareholder resolution, most aggressive weapon of shareholder activism(section 111). In regards to the voting methods, keeping in mind the scattered presence of minority shareholders, section 110 of Companies Act 2013¹⁴, the facility of Postal ballot was introduced to increase participation of the company. The shareholders could convey their voting preferences by simply writing a 'Yes' or 'No' to the resolutions to be put forward for voting in the forthcoming Annual General Meeting. However this step failed to create much of an impact. In 2012, another revolutionary measure which was taken by SEBI was the introduction of Electronic Voting. It was ordered that that the top 500 listed companies on BSE and NSE were required to introduce electronic voting facility.¹⁵ It reduced the paperwork to the minimum and ensured larger participation due to greater access to internet access to most investor these days. Later in form of section 108, voting by electronic means formally became a part of Companies Act, 2013.

Some other key features in regards to strengthening Corporate Governance in Companies Act 2013, **respect of promotion of Investor's protection and fair disclosure policy include the concept of class action suits (section 245)** which enables investors to file complaint against the company or the management before the Tribunal and seek any damages or compensation or demand any other suitable action against who was involved in making any improper or misleading statement of particulars in the audit report or who acted in a fraudulent, unlawful or wrongful manner. The key advantage of encouraging the class action suits which hitherto were filed as which had uncertain faith **will now have an improved status under the act. This in turn will keep "Indian companies, its management, directors, auditors, on their toes and looking over their shoulders for potential legal action.**¹⁶ Furthermore, establishment of **Serious Fraud Investigation Office (SFIO) under Section 211 of the act will have the powers to investigate frauds relating to companies including "arrest in respect of certain offences those proved as "fraud". The provision of appointment of Independent Director under Section 149(6),** which has been introduced for the first time comprehensively stipulates the qualifications holds promise for the independent Director and act as watchdog over the affairs of the company in ensuring that nothing happens which can jeopardise the interest of the stakeholders of the company.

Securities Exchange Board of India (SEBI)

The Securities and Exchange Board of India (SEBI) is the regulator for the securities market in India. It was officially established by the Government of India in the year 1988 and given statutory powers in 1992 with SEBI Act 1992 being passed by the Indian Parliament.



The main functions of the Board are regulating the business in stock exchanges and any other securities markets along with registering and regulating the working of stock brokers, promoting and regulating self-regulatory organisations, prohibiting fraudulent and unfair trade practices relating to securities markets and promoting investors' education and training of intermediaries of securities markets. The Preamble of the Securities and Exchange Board of India describes the basic functions of the SEBI as "...to protect the interests of investors in securities and to promote the development of, and to regulate the securities market and for matters connected therewith or incidental thereto". Thus, SEBI has a definite and positive role in protecting the interest of shareholders. Shareholder Associations, which have recognition under SEBI are organised groups representing shareholders concerns. These play an important part in keeping a check on the activities of the companies and voicing the concerns of the investors. There are 26 recognised Shareholder Associations in India¹⁷. Some of the prominent associations recognised by Consumer Education and Research Society, Gandhinagar; Federation of Consumer Associations, West Bengal; Midas Touch Investors Association, Kanpurand, The Bombay Shareholders' Association, Mumbai. These accredited investor associations meet at regular intervals with SEBI officials to apprise about the issues and complaints which the investors are facing steps taken by SEBI to resolve them in an efficient manner.¹⁸

As far as codes on corporate governance are concerned, recommendations by the Kumar Manglam Birla committee have been the most prominent which led to its adoption in the listing agreement of companies. It includes certain mandatory and non-mandatory recommendations including to enhance the corporate governance standards across the corporate sector. Other recommendatory codes were Confederation of Indian Industries (CII) Code recommendations (1996) were the next in line which emphasised on good corporate governance measures to be adopted. Similar suggestions were made by Birla Committee (SEBI) recommendations (2000) and N. Narayan Murthy Committee (2003). The latest addition to the list is the Voluntary Guidelines 2009 by Ministry of Corporate Affairs, Government of India¹⁹ in December 2009. Although it does not provide any concrete measures specifically for investor protection, but it underscore and exemplify the importance of corporate governance in general.

Comparative Analysis of the investor protection policy framework in US, UK and India

<i>Basis</i>	<i>USA</i>	<i>UK</i>	<i>India</i>
Statutory Framework	Securities Exchange Act 1934, Sarbanes- Oxley Act, 2002	Companies Act, 2006 Financial Services Act, 2012	SEBI Act, 1992 Companies Act, 2013
Regulatory Authorities	Securities and Exchange Commission	Financial Conduct Authority (FCA)	Securities Exchange Board of India
Codes	Calpers Global Corporate Governance Principles, 1996 Principles of Corporate Governance, Business Round Table, 2012	Cadbury Committee Codes in the year formally adopted in the Listing Agreement UK Stewardship code (Institutional investors by UK Financial Reporting Council)	Kumar Mangalam Birla Committee Codes Formally adopted in Listing Agreement. Corporate Governance Voluntary Guidelines 2009



5. Lessons to Learn for India

1. Unlike US (Sarbanes - Oxley Act, 2002) and UK (Financial Services Act, 2012) a separate act focusing specifically on strengthening the shareholders rights in the country is still lacking in India.
2. A lacuna of a response system to financial distress in the form of a regulatory authority is conspicuous. **SEBI's inability to handle crisis is evident in its inability to prevent the National Spot Exchange Limited (NSEL) fiasco** which shows that a separate authority catering to the specific needs for prevention of fraudulent practices against duping small shareholders is urgent need of the hour.
3. After the scandalous decade 1990s, clause 49 was a commendable step towards better governance measures. However, since then there lies a vacuum of releasing specific codes requiring mandatory adoption to prevent frauds. Satyam fiasco did lead to release of voluntary guidelines by the Ministry of Corporate Affairs, but they scarcely mention investor protection in its text.

6. Shareholder Activism- World-wide Trends

There were series of developments in America during the second half of the 20th Century, more importantly during 1950 when the number of proposals for general empowerment of shareholder through more participatory AGMs and transparent reporting were introduced by enlightened shareholders.²⁰ Rule 14a-8 of the Securities and Exchange Act of 1934, which lays out the process and rules related to shareholder proposals was also included around that time only. This further encouraged establishment of legitimate avenues for shareholders to voice their opinion which included networks and organisations which bought together the activist shareholders under one roof. These developments paved way for establishment of groups such as the Council on Economic Priorities, the Corporate Information Center, and the Interfaith Center on Corporate Responsibility (ICCR), which were important players in the beginning of an overall social movement. The recent years have witnessed emergence and shaping of shareholder activism from dormancy and are beginning to engage both shareholders and the corporate management. During the last 30 years Shareholder Activism has grown by leaps and bounds as a result of the convergence of several factors the most important among those was the increased ability of large shareholders to organise and communicate.

Since the first half of the first decade of 21st century, the developed countries like the U.S. and the U.K. witnessed the concept of Shareholder Activism in an unprecedented way. The period from 2004 to 2007 can be marked as the most active season for shareholder campaigns in USA.

A number of companies were targeted by activist for varied reasons by shareholders for changes corporate structure. The Trian Fund Management LP led by Nelson Peltz after acquiring more than five percent stake in H.J. Heinz company, entered into a proxy fight aiming to win 5 seats on Board of Directors. Peltz was successful in gaining two seats which later on helped him to adoption of a turnaround plan for the company aiming for cost cutting asset restructuring which later on turn out to be extremely beneficial for company.²¹ In the same line the People for Ethical Treatment of Animals (PETA) has been active in protesting animal testing and have organised several shareholder



campaigns against score of companies against the cruelty of companies against animals. The campaigns against Chevron- Texaco²², Du Pont and Pfizer²³ are few to mention. In all three cases the common aim was to promote adoption of state-of-the-art and scientifically valid non-animal methods that were already in use in other countries.²⁴

There are various issues which have gained attention of the stockholders to make companies more accountable towards corporate boards. Majority voting for election of director is one of them. For instance, a leading international law firm reported that in the year 2006 alone, more than 150 shareholder proposals demanding voting majority were filed. United Brotherhood of Carpenters Pension Fund, an institutional shareholder was one of the forerunners in demanding adoption of these guidelines.²⁵

However, there are certain contentious issues which need thoughtful deliberations. Say on pay is another contentious issue on the activists minds. This is evident from the fact that in 2006 alone, seven companies faced shareholder protests by most eminent institutions were supporting such proposals including calPERS, New York City Pension funds and Amalgamated Bank Longview Funds. Various mutual funds also showed their support in favour of the Say on Pay proposals including Fidelity Investments, Vanguard among others. Various companies such as Morgan Stanley and United Technologies faced protests in 2007 on the same lines.²⁶

Similarly, Kirk Kerkorian acquired nearly 10 percent stake in General Motors in the year 2005 and became the third largest shareholder in the company. He then relentlessly pushed to carve out strategies to make GM a profitable concern, for providing more value to the shareholders including his attempt for alliance of GM with Nissan and Renault.²⁷ However, the deal did not materialise and he exited the company selling his shares. His exit negatively affected the automotive operations of GM and company experienced a loss to its European and Japanese counterparts in the industry.²⁸

Hedge Fund – A New Tool of Activism

Hedge funds are investment vehicles that explicitly pursue absolute returns on their underlying investments. The appellation "Absolute Return Fund" would be more accurate, not least as not all hedge funds maintain an explicit hedge on their portfolio of investments. During the recent years, Hedge Fund Activism has emerged strongly, particularly after the global financial crisis. One of the few notable examples is the acquisition of Alberta Investment Management Corporation (Aimco), a Canadian pension fund along with Jana Partners, a hedge fund, in TNT in the year 2009.²⁹ The European postal service giant had been experiencing fall in its operations due to liberalisation policy adopted by Netherlands which led to increased competition. Later on the Aimco and Jana were able to successfully demerge TNT into TNT Express and Dutch postal company Post NL by garnering shareholders support in an EGM in 2011.³⁰

Jana Partners has played a role of a proactive investor in various other companies. In 2010 it acquired a 7 percent stake in Charles River Laboratories and registered its dissent against its acquisition plan of WuXI PharmaTech (Caymen) which the company ultimately cancelled. In 2011, Jana was successfully able to spilt production and exploration units of El Paso Corp after it acquired 4 percent stake in the company.³¹



Goldman analysts remarks that "activist funds have returned 40 % during the past two years vs. 23% for the typical equity hedge fund". They analysed 778 hedge funds with a combine \$1.8 trillion in gross equity positions (International Business Times, May 13, 2014). Another Activist hedge funds which was in news in 2009 was Relational Investors along with CalSTRS, California's state pension fund for teachers organised a shareholder campaign against Occidental Petroleum for the exorbitant executive remunerations pay packages of the executive and reappointment of Ray Irani's as CEO even after attainment of retirement age. They were successfully able to win the motion and implemented the Say on Pay policy with Steve Chasen chosen as the new CEO replacing Irani.³²

In May 2012, U.K. witnessed the outrage of shareholders forced CEO of three companies namely publisher Trinity Mirror, insurer Aviva and pharmaceutical company AstraZeneca to put their papers for drawing hefty salaries³³. In U.S. Vikram Pandit faced sharp criticism on proposed \$15 million pay package which the shareholders vehemently rejected. This primarily happened after Dodd-Frank, bestowed shareholders with a "say on pay." which Securities and Exchange Commission later formally adopted³⁴.

7. The Road Ahead- Indian Prospects

7.1 Current Scenario

Off late a number of activism cases have been reported in media. The onset was in October 2011 with the Purchase of a Rs. 270 crore aircraft by Crompton Greaves which was resisted by its institutional investors forcing the company to eventually sell it off.³⁵ Soon after that, Children Investment Fund, A minority shareholder in Coal India Limited voiced its opinion against the PSU for not selling coal at competitive prices affecting the shareholders interest. Other instances were also around the same time when investors of the Akzo Nobel India opposed the amalgamation of three unlisted companies. Even though the amalgamation took place the royalty payment was reduced from 3% to 2% due to shareholders protests.³⁶

Having identified the potential of Institutional investors having the voice and weight to make an impact, SEBI directed the Mutual funds to reveal their voting patterns in Annual General meetings. Since then, a rise in institutional activism has been observed. Mutual funds vote on behalf of the unit holders. This is also called Proxy voting. Investors Funds such as Reliance Mutual Fund, DSP Blackrock, HDFC and UTI were involved in separate instances ranging from voting against various proposals and resolutions in AGMs of companies these MFs hold portfolios³⁷. Lately SEBI advised Insurance companies to play a more active role as block holders for better vigilance³⁸. It is indeed noteworthy to mention here that SEBI has been playing an instrumental role in protecting the shareholders and guiding them from coming out of the gallows of bleak horizons.

7.2 New Horizons in Shareholder Activism -Proxy Advisory Firms

Proxy Advisory Firms are common in countries like U.S. and U.K. the most famous being Glass, Lewis & Co. and Institutional Shareholder Services. This concept is slowly catching up in India as well. There are three proxy advisory firms in India at present namely Ingovern, Stakeholder Empowerment Services and Institutional Investor Advisory Services. These firms provide voting recommendations to their clients on various Corporate Governance issues. They also take the initiative of informing and making the common investors aware of the contentious issues and



identifying the red flags in the deals undertaken by large corporate at the cost of the interest of the shareowners. One example worth noting is that when N. R. Narayana Murthy joined as chairman of Infosys Ingovern advised shareholders to vote against the resolution to bring him as executive chairman on grounds of 'in violation of the spirit of corporate governance espoused by the company'³⁹. Ingovern also comes out with an yearly report on Proxy season in India wherein it summaries the voting trends by institutional investors on the resolutions put forward in companies. This can be helpful in paving the path for the future road ahead for shareholder Activism in India.

Following the international trend it is quite evident that activism as phenomena of Corporate Governance is assuming importance and recognition in the corporate arena. No company management can disparage the importance of increased investor autonomy in major business deals where considerable interest of the shareholders is at stake. Holcim-Ambuja Cements restructuring deal represents a conspicuous example of this. The idea of shareholder activism has an undoubted potential in improving the Indian business scenario and thereby impacting the Indian Economy as a whole. The increased public recognition of this phenomenon along with statutory support will make India an enviable option for increased foreign investment destination for investment vis-à-vis other developing nations. However, a concentrated effort on part of the Institutional investors is inevitable necessity to show the solidarity toward higher cause of investor sovereignty.

8. Dark Side of Shareholder Activism

Hedge fund activism is a new branch in shareholder activism. Hedge funds as defined by International Monetary fund⁴⁰ as "Hedge funds are eclectic investment pools, typically organized as private partnerships and often located offshore for tax and regulatory reasons. Their managers - who are paid on a fee-for-performance basis - are free to use a variety of investment techniques, including short positions and leverage, to raise returns and cushion risk." Therefore, it can be construed that the managers have a vested personal interest to maximise their asset value. Engaging in activism helps them steer the company in the direction they want to, which not necessarily would be in the larger interest of the shareholders. Since hedge funds are investment vehicles meant for wealthy investors and are involved in short selling, derivative trading and leverage or arbitrage they are exempt from stringent laws⁴¹. This is due to the very nature of their investment strategy. Hence there is every possibility that the hedge fund activist may acquire a large stake in the company, force their decisions on the management and exit early after making profits hampering the future growth prospects of the firm. This short term policy for personal gain can also impact the market volatility with a potential of destabilising the economy. Few authors have term this phenomenon as short termism.⁴²

Another possibility of shareholder activism going wrong is when it leads to a falling shareholder's value. This can be illustrated with the acquisition of Blockbuster Ltd shares by Carl C. Icahn in the year 2005.⁴³ Icahn is a successful shareholder activist and have been victorious in making loss making companies in to profitable entities by amassing stocks and pressurising management. The anticipation of increase in the DVD rentals business led Icahn to buy a stake worth 17 million shares in Blockbuster Ltd. He aimed at gaining seats at the board to implement strategies to boost business and curb hefty pay packages drawn by the executives. However, the business could not keep pace with changing consumer preferences and slash in DVD prices which eventually led the company to file for bankruptcy in 2010.



Investor Activism can also hamper the interest of the minority stockholders if the Institutional Investors collude with the board. Such instances occur in emerging economies where shareholder protection laws are weak. It has been observed that in China after the split share structure reform was adopted, institutional investors were being lured by the other majority shareholders for ownership rights in exchange of insider information which can be beneficial in terms of abnormal stock returns.⁴⁴ Poorly conceived activism strategy can also lead to ousting of experienced and proficient CEOs. Few CEOs voluntarily exit due to large scale dissent. This can impact long term value of the firm which could have benefitted from the expertise of visionary CEO. Activism not weighed against cost benefit analysis can prove counterproductive.⁴⁵

9. Conclusion

Conspicuously, India is lurching towards Shareholders Activism and valiantly moving forward with a new set of corporate governance framework in order to streamline the existing deficiency in the governance structure and be in sync with the up gradation in corporate framework of the developed part of the world. The gist of the above discussion may be concluded in a single sentence, Shareholder Activism is here to stay.

End Notes

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LENIENCY PROGRAMMES UNDER ANTI-TRUST LAWS

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Introduction

Leniency is a generic term to describe a system of partial or total exoneration from the penalties that would otherwise be applicable to a cartel member which reports its cartel membership to a competition enforcement agency. In addition, agency decisions that could be considered lenient treatment include agreeing to pursue a reduction in penalties or not to refer a matter for criminal prosecution. The terms immunity, leniency and amnesty are used in various jurisdictions to describe partial or total exoneration from penalties but are not synonymous in all jurisdictions. A leniency policy describes the written collection of principles and conditions adopted by an agency that govern the leniency process. A leniency policy is one component of a leniency program, which also includes internal agency processes, for example how the agency implements their leniency policy.¹

An increasing number of competition authorities operate leniency programmes (sometimes also called immunity or amnesty programme) as a key tool to detect cartel infringements. In criminal law, there is a provision for pardon, wholly or partly, in respect of offences perpetrated, if the guilty admits the offence and turns as an approver to bring home the guilt of others.

On the analogy of criminal jurisprudence, when a member of Cartel breaks the rank and make full, true and vital disclosures which results in bursting the 'Cartel', the Competition Commission of India (CCI) has been empowered to levy lesser penalty under the Competition Act, 2002. The scheme is designed to induce member of a Cartel to defect from the cartel agreement. The party making disclosure will, however, be subject to other directions of the CCI as per provisions of the Act.²

Rationale for Assessing Cartels in India

Competition law in India seeks to promote, maintain and sustain competition in market being beneficial to various stakeholders in society. 'Cartel' is presumed to have Appreciable Adverse Effect on Competition (AAEC). In case of 'Cartel', competitors agree not to compete on price, product, customers etc. Since in the case of a Cartel, direct competitors agree to forego competition and opt for collusion, the consumers and business houses lose the benefits of competition. Thus, cartels are inherently harmful. Further, competitors know that such an agreement is unlawful and it compels them to keep such agreement secret and consequently it is invariably not reduced to writing and it is often found to be in the form of arrangement or understanding. Moreover, the best evidence against 'Cartel' is usually in possession of the charged parties, which are not likely to easily part with and make available to the investigator or enquiring authority. These compulsions seem to have persuaded the law makers in India to prescribe that 'Cartel' is presumed to have appreciable adverse effect on competition.

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The views expressed are personal views of the author(s) and do not necessarily reflect those of the Institute.

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Cartels are particularly a form of anti-competitive activity. Their purpose is to increase prices by removing or reducing competition and as a result they directly affect the purchasers of the goods or services, whether they are public or private businesses or individuals. Cartels also have a adverse effect on the wider economy as they remove the incentive for businesses to operate efficiently and to innovate.

Cartels are agreements between enterprises (including association of enterprises) not to compete on price, product (including goods and services) or customers. The objective of a cartel is to raise price above competitive levels, resulting in injury to consumers and to the economy. For the consumers, cartelization results in higher prices, poor quality and less or no choice.

Enterprise is defined in section 2 (h) of the Competition Act, 2002 as to means a person or a department of the Government, who or which is, or has been, engaged in any activity, relating to the production, storage, supply, distribution, acquisition or control of articles or goods, or the provision of services, of any kind, or in investment, or in the business of acquiring, holding, underwriting or dealing with shares, debentures or other securities of any other body corporate, either directly or through one or more of its units or divisions or subsidiaries, whether such unit or division or subsidiary is located at the same place where the enterprise is located or at a different place or at different places, but does not include any activity of the Government relating to the sovereign functions of the Government including all activities carried on by the departments of the Central Government dealing with atomic energy, currency, defence and space". A cartel is said to exist when two or more enterprises enter into an explicit or implicit agreement to fix prices, to limit production and supply, to allocate market share or sales quotas, or to engage in collusive bidding or bid-rigging in one or more markets.

International Cartels - An international cartel is said to exist, when not all of the enterprises in a cartel are based in the same country or when the cartel affects markets of more than one country.

Import Cartels - Import cartels comprise enterprises (including association of enterprises) that get together for the purpose of imports into the country.

Export Cartels - An export cartel is made up of enterprises based in one country with an agreement to cartelize markets in other countries. In terms of provisions of the Competition Act, 2002 cartels meant exclusively for exports have been excluded from the provisions relating to anti-competitive agreements.

Cartels to be void - Agreements between enterprises engaged in identical or similar trade of goods or provision of services (commonly known as horizontal agreements), including cartels, of four types specified in the Act are presumed to have appreciable adverse effect on competition and, therefore, are anti-competitive and void.

Common Features of Cartel - Usually cartels function in secrecy. The members of a cartel, by and large, seek to camouflage their activities to avoid detection by the authorities. Perpetuation of cartels is ensured through retaliation. If any member does not abide, the other cartel members retaliate through temporary price cuts to take business away or can isolate the non abiding member. Another method, known as compensation scheme, is resorted to in order to discourage indiscipline. Under this scheme, if the member of a cartel is found to have sold more than its allocated share/ it would have to compensate the other members.



Conditions Conducive to Formation of Cartels - Small number of firms in an industry, high concentration, barriers to entry, low technological advancement, homogeneous product, strong ability of competing firms to exchange information on price and other terms of sale, uniformity in cost or efficiency, severe punishment which can be inflicted on the cheater, and effective trade association etc. make it conducive for firms to cartelize and to continue as such on a long term basis. The less fear of detection and punishment also encourages firms to cartelize.

If there is effective competition in the market, cartels would find it difficult to be formed and sustained. Some of the conditions that are conducive to cartelization are:

- high concentration - few competitors
- high entry and exit barriers
- homogeneity of the products (similar products)
- similar production costs
- excess capacity
- high dependence of the consumers on the product
- history of collusion
- Possibility of getting detected and punished
- Likelihood of cheating
- Quantum of benefits expected from cartelisation over and above penalties which can be imposed

LENIENCY PROGRAMMES

Leniency programmes are considered to be the most effective tool today for detecting cartels and obtaining evidence to prove their existence and effects. These programmes involve a commitment to a pattern of penalties designed to increase incentives to cartelists to self-report to the competition law authority.

In many countries there is a concept of Marker systems in leniency programmes. A marker system is a system whereby an entity can claim a position in the queue of all those seeking to make a disclosure. The catch is that this is done without providing all the information that would be necessary to complete the application. In other words, certain basic information has to be given at the time the marker is claimed. Such information may include information related to the parties to the cartel, the duration and nature of illegality, the product markets and territorial markets affected, and any parallel leniency applications. However, the detailed information on the financial position of the enterprise making the application and other such information can be submitted later. Countries which have introduced marker system in their leniency programme include Australia, Brazil, Bulgaria, Canada, Cyprus, Czech Republic, European Commission, France, Germany, Romania, turkey, UK and U.S.

In the U.S., this program is arguably the most significant policy development in the fight against cartels since the Clayton Act instituted private treble damages in 1914. The 1993 revision of the Corporate Leniency Program of the U.S. Department of Justice's Antitrust Division gives a member of a cartel the opportunity to avoid government penalties if it is the first to fully cooperate and provide evidence. The widespread usage of the leniency program in the U.S. soon led to the adoption of



similar programs in other countries. In 1996, the European Commission (EC) instituted a leniency program and a decade later 24 out of 27 EU members adopted the leniency programmes. Today, leniency programs are found across the globe from Canada to the United Kingdom to Japan to South Africa to Brazil.

Essential elements of an Effective Leniency Programme/Policy

OECD Report on Leniency Programmes observed that the key to an effective leniency programme is that there should be a high degree of predictability, transparency and certainty, together with a low burden of proof, heavy penalties and an emphasis on priority.

The US Department of Justice identifies six key components of an effective leniency policy, as under :

1. transparency and predictability of the operation of the policy
2. maximum possible reward for those who qualify
3. the benefits of the policy should be limited to the first to qualify
4. the policy should provide full protection for cooperating corporate executives
5. the cooperation requirements of the policy should be clear and not related to the value of the evidence
6. the policy should provide for prompt notification to the applicant of the outcome of their application.

Prof. Richard Whish at the ICN Curriculum Module observed that :

1. There should be severe sanctions for members of a cartel who do not report them to a competition authority.
2. It should be clear that there is a high degree of likelihood that participants in cartels who do not report them to a competition authority will be discovered and punished.
3. The leniency programme itself should be transparent and predictable so that firms understand precisely how the process of making an application to a competition authority will work.

LENIENCY PROGRAMME IN INDIA

Section 46 of the Competition Act, 2002 provides that "The Commission may, if it is satisfied that any producer, seller, distributor, trader or service provider included in any cartel, which is alleged to have violated section 3, has made a full and true disclosure in respect of the alleged violations and such disclosure is vital, impose upon such producer, seller, distributor, trader or service provider a lesser penalty as it may deem fit, than leviable under this Act or the rules or the regulations:

Provided that lesser penalty shall not be imposed by the Commission in cases where the report of investigation directed under section 26 has been received before making of such disclosure.



Provided further that lesser penalty shall be imposed by the Commission only in respect of a producer, seller, distributor, trader or service provider included in the cartel, who has made the full, true and vital disclosures under this section.

Provided also that lesser penalty shall not be imposed by the Commission if the person making the disclosure does not continue to cooperate with the Commission till the completion of the proceedings before the Commission.

Provided also that the Commission may, if it is satisfied that such producer, seller, distributor, trader or service provider included in the cartel had in the course of proceedings,—

1. not complied with the condition on which the lesser penalty was imposed by the Commission; or
2. had given false evidence; or
3. the disclosure made is not vital, and thereupon such producer, seller, distributor, trader or service provider may be tried for the offence with respect to which the lesser penalty was imposed and shall also be liable to the imposition of penalty to which such person has been liable, **had lesser penalty not been imposed.”**

Conditions to avail Benefits of Leniency Provisions

The applicant must:

- i. provide the information before the receipt of the report of investigation directed under section 26 of the Act.
- ii. cease to further participate in the cartel from the time of its disclosure unless otherwise directed by the Commission.
- iii. provide vital disclosure in respect of violation under subsection (3) of section 3 of the Act.
- iv. provide all relevant information, documents and evidence as may be required by the Commission.
- v. co-operate genuinely, fully, continuously and expeditiously throughout the investigation and other proceedings before the Commission.
- vi. not conceal, destroy, manipulate or remove the relevant documents in any manner, which may contribute to the establishment of a cartel.
- vii. The reduction in monetary penalty will depend upon following situations:-
 - the stage at which the applicant comes forward with the disclosure,
 - the evidence already in possession of the Commission,
 - the quality of the information provided by the applicant,
 - the entire facts and circumstances of the case.



Procedure for Grant of Lesser Penalty

- The applicant can make application as per the contents specified in the Schedule either orally, or through e-mail or fax to the designated authority
- The Commission shall mark the priority status of the applicant and the designated authority shall convey the same to the applicant but mere acknowledgement shall not entitle the applicant for grant of lesser penalty
- The date and time of receipt of the application by the Commission shall be the date and time as recorded by the designated authority
- Unless the evidence submitted by the first applicant has been evaluated, the next applicant shall not be considered by the Commission.
- Lack of continuous cooperation entitles Commission to reject the application after providing due opportunity of hearing to that applicant.
- After rejection of the priority status of first applicant, the subsequent applicants shall move up in order of priority for grant of priority status by the Commission.

Quantum of Immunity under Leniency Provisions

The quantum of immunity available under leniency provisions in comparison to penalty prescribed under clause (b) of the section 27 of the Act is as under:-

- Benefit of reduction in penalty upto or equal to 100% is available to the applicant if he is the first to make a vital disclosure enabling the Commission to form a prima-facie opinion regarding the existence of a cartel on the basis of evidence submitted.
- Benefit of reduction in penalty upto or equal to 100% is available even if the matter is under investigation but without disclosures made by the applicant; the Commission or the Director General did not have sufficient evidence to establish such a contravention
- Benefit of reduction in penalty upto or equal to 100% will only be considered, if at the time of the application, no other applicant has been granted such benefit by the Commission.
- The second or third applicant in the priority status may also be granted benefit of reduction in penalty to the tune of 50% and 30% of the full leviable penalty respectively on making a disclosure by submitting evidence, which provide a fillip to the already available evidence with the Commission or Director General for establishing the existence of the cartel.

Leniency Programmes – International Position

United Kingdom

The two principal national legislation dealing with cartel activity in the United Kingdom are the Competition Act 1998 and the Enterprises Act 2002 (both amended by the Enterprise and Regulatory Reform Act 2013). The Office of Fair Trading (OFT) has been closed on March 31, 2014 and the responsibility for cartel enforcement is taken over by the Competition and Markets Authority (CMA) on April 1, 2014).



The following is the types of leniency provided under OFT leniency programme :

Type A immunity: First to come forward and no pre-existing investigation

Type B immunity: First to come forward but there is a pre-existing investigation

Type C leniency: Not first to come forward but can 'add significant value'

Canada

In Canada the Competition Act, 1985, Competition Rules 1985 and Competition Rules 2005 regulates cartel activity and controlled by Competition Tribunal and Competition Bureau. The process involved in availing the leniency programmes is as under :

Requesting a Leniency Marker : A "leniency marker" is the acknowledgement given to a leniency applicant (Applicant) that records the date and time of an applicant's application to the Leniency Program. It establishes the applicant's position in line in relation to other individuals or organizations seeking to participate in the Leniency Program. The leniency marker guarantees the applicant's position in line, subject to the applicant meeting all of the other criteria of the Leniency Program.

The Proffer : After receiving a leniency marker, an applicant must provide the Bureau with a statement known as a proffer. In a proffer, an applicant describes in detail the illegal activity, its role in the offence for which leniency is sought, and the effect of the illegal activity in Canada. The applicant must also outline all of the supporting evidence and witnesses that it can provide at that point in time as part of its cooperation under the Leniency Program. The Bureau considers a proffer to be complete on receipt of sufficient information to make a leniency recommendation to the Public Prosecution Service of Canada (PPSC).

Japan

The cartel activities in Japan is regulated by Japan Fair Trade Commission (JFTC) and provides for the following immunity under its leniency programme.

- (1) Full immunity from surcharges is offered to the entrepreneur who is the first among the entrepreneurs that committed the violative activities to apply for leniency before the JFTC's investigation is initiated.
- (2) Japan has a system whereby the JFTC has some discretion to bring criminal charges at the Prosecutor General against an entrepreneur and its employees engaging in cartel activities.
- (3) Under the Japanese leniency programme, a total maximum of three entrepreneurs, including those who apply for leniency after an investigation is initiated, can receive immunity from or reduction of surcharges.
- (4) To heighten the incentive to provide the JFTC with information as early as possible, a marker system has been introduced.
- (5) To apply for leniency, the applicant must transmit by facsimile a written report providing the necessary information. It is sufficient, however, for applicants to report detailed information orally rather than in writing.
- (6) The application form must be completed in Japanese. If relevant materials are written in foreign languages, the key points of these materials should be selected out and translated into



Japanese. As for parts other than the key points of the materials, applicants are only required to prepare a Japanese translation of such parts if so requested by the JFTC.

Malaysia

Section 41 of the Malaysian Competition Act 2010 of Malaysia provides for a leniency regime with a reduction of up to a maximum of 100% of any penalties that would be otherwise imposed. In essence, the leniency program is designed to encourage those who are involved in cartel practices to whistle blow by cooperating with the Commission in identifying the infringement. The cartel activities are controlled by Malaysia Competition Commission.

Section 41 of the Malaysian Competition Act states that there shall be a leniency regime, with a reduction of up to a maximum of one hundred percent of any penalties which would otherwise have been imposed, which may be available in the cases of any enterprise which has—

- (a) admitted its involvement in an infringement of any prohibition under sub-section 4(2); and
- (b) provided information or other form of co-operation to the Commission which significantly assisted, or is likely to significantly assist, in the identification or investigation of any finding of an infringement of any prohibition by any other enterprises.

(2) A leniency regime may permit different percentages of reductions to be available to an enterprise depending on—

- (a) whether the enterprise was the first person to bring the suspected infringement to the attention of the Commission;
- (b) the stage in the investigation at which—
 - (i) an involvement in the infringement was admitted; or
 - (ii) any information or other co-operation was provided; Or
- (c) any other circumstances which the Commission considers appropriate to have regard to.

Singapore

The cartel activities in Singapore are controlled by Competition Commission of Singapore (CCS). The following are the highlights of the leniency programme provided.

Eligibility for leniency application

The Leniency Programme offers different levels of benefits to businesses depending on:

- Whether the business is the first to come forward with information about the cartel; and
- Whether CCS has already commenced investigations when the undertaking comes forward.
- Total immunity from financial penalties

Reduction of up to 100% in the level of financial penalties : If a business is the first to come forward to CCS seeking leniency and it satisfies all the requirements but it only comes forward after CCS has started an investigation, such business undertaking does not qualify for total immunity but it



may still qualify for a reduction of up to 100% of the financial penalty. The extent of the reduction depends, amongst others, on:

- The stage of the investigation at which business came forward;
- **The evidence that is already in CCS' possession; and**
- The quality of the information provided by business.

Reduction of up to 50% in the level of financial penalties : If a business is not the first to come forward, it may still be granted a reduction of up to 50% of the financial penalty if it come forward before CCS issues a notice of proposed infringement decision under section 68(1) of the Act.

Quality of Information provided by the leniency applicant : Regardless of whether applying for immunity, reduction of up to 100% or reduction of up to 50% in the level of financial penalties, a business will have to, at a minimum, provide information and evidence to CCS which would allow CCS to commence an investigation or add significant value to an ongoing CCS investigation.

Leniency Plus : In addition to the leniency programme, CCS also operates a leniency plus programme. Leniency plus incentivises businesses that are co-operating with CCS in a cartel investigation in one market (the first market) to inform CCS about their participation in a completely separate cartel in another market (the second market). To qualify for leniency plus a business would have to satisfy CCS:

- That the information and evidence provided by the business relating to the cartel in the second market, is in fact a completely separate cartel from the cartel in the first market; and
- That the business is the first to come forward to CCS with information and evidence about the cartel in the second market and would thus qualify for immunity from financial penalties or a reduction of up to 100%.

If CCS is satisfied of the above, the business is granted leniency (either immunity or a reduction of up to 100%) in relation to the cartel in the second market and it is also be granted a reduction in the financial penalties imposed against it in the investigation in the cartel in the first market, this reduction in financial penalties is in addition to any reduction it has received for its co-operation in the investigation in the first market.

United States of America

The Department of Justice, Antitrust Division gives a leniency applicant a "marker" for a finite period of time to hold its place at the front of the line for leniency while counsel gathers additional information through an internal investigation to perfect the client's leniency application. While the marker is in effect, no other company can "leapfrog" over the applicant that has the marker.

Type A Leniency : Leniency is granted to a corporation reporting illegal antitrust activity before an investigation if the following six conditions are satisfied :

- At the time the corporation comes forward, the Division has not received information about the activity from any other source.



- Upon the corporation's discovery of the activity, the corporation took prompt and effective action to terminate its participation in the activity.
- The corporation reports the wrongdoing with completeness and provides full, continuing, and complete cooperation to the Division throughout the investigation.
- The confession of wrongdoing is truly a corporate act, as opposed to isolated confessions of individual executives or officials.
- Where possible, the corporation makes restitution to injured parties.
- The corporation did not coerce another party to participate in the activity and clearly was not the leader in, or the originator of, the activity.

If the corporation does not meet all above of the Type A Leniency conditions, it may still qualify for leniency if it meets the conditions of Type B Leniency.

Type B Leniency : A company qualifies for leniency even after the Division has received information about the illegal antitrust activity, whether this is before or after an investigation is formally opened, if the following conditions are satisfied:

- The corporation is the first to come forward and qualify for leniency with respect to the activity.
- At the time the corporation comes in, the Division does not have evidence against the company that is likely to result in a sustainable conviction.
- Upon the corporation's discovery of the activity, the corporation took prompt and effective action to terminate its part in the activity.
- The corporation reports the wrongdoing with candor and completeness and provides full, continuing, and complete cooperation that advances the Division in its investigation.
- The confession of wrongdoing is truly a corporate act, as opposed to isolated confessions of individual executives or officials.
- Where possible, the corporation makes restitution to injured parties.
- The Division determines that granting leniency would not be unfair to others, considering the nature of the activity, the confessing corporation's role in the activity, and when the corporation comes forward.

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COMPANIES ACT, 2013 – MAKING CS A DISTINCT BUBBLE OF AN OCEAN

AKINCHAN BUDDHODEV SINHA*

The Preamble

From a "Note Taker" at board meetings or "Administrative Servant of the Board" to "Board Advisor" and guardian of "Corporate Governance", a radical change in the role of a Company Secretary ushered in by the new Companies Act, 2013. Today the Board, especially, the chairman, **relies on the company secretary to advise them not only on directors' statutory duties under the law,** disclosure obligations and listing rule needs but also with reference to corporate governance requirements and practices and effective board processes. This specialized role of the modern company secretary has positioned them as key governance professionals within the organization.

The responsibility for developing and instituting mechanisms to foster and sustain good corporate governance has fallen in a big way within the ambit of the company secretary. This is recognized even in the UK Code of Corporate Governance (which has been adopted by the Irish Stock Exchange through the Irish Annex) and the FRC Guidance on Board Effectiveness. Both have served to focus companies on Board effectiveness and in turn how they can be helped by the company secretary.

It can be said unequivocally that boardroom dynamics are witnessing a sea change and chairman and directors have clearly understood that they require specialist skills and technical knowledge in this area and they are heavily banking upon company secretaries to offer this expertise.

The New Companies Act, 2013 have ushered with it plethora of opportunities as well as challenges for a company secretary. Now it is up to the '*Governance Professionals*' to extract maximum out of it, i.e. by exercising their knowledge, prudence and expertise they need to ensure that corporate houses stick to the best governance practices. Through discussion on certain amendments to existing provisions or addition of new provisions in new Companies Act, 2013, this article makes an endeavour to explore how the new Companies Act, 2013 have acted as a vehicle in enhancing the value of a company secretary.

Widening Contours

The assent on the long awaited Companies Bill on 18th of December, 2012 in the Lok Sabha and 8th of August, 2013 in the Rajya Sabha gave birth to a not just another Act, rather it was like a new dawn for the company secretaries, thereby playing a pivotal role in widening their duties and powers. The incorporation of important amendments in the provisions pertaining to governance, e-management, compliance and enforcement, disclosure norms, auditors and mergers and acquisitions and introduction of new concepts like One-Person Company, small companies, dormant company, class action suits, registered valuers, Corporate Social Responsibility etc. in new Companies Act, 2013, have acted as a game changer for the company secretaries, as it has enhanced their role and armed them with more authority as evident from their growing importance in all phases of a company, i.e. right from its inception to when it comes into full-fledged operation and in other

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important events in the voyage of a company. In other words, now a company secretary steps into all major activities of a business, i.e. Share capital related matters; Management; Administration and Corporate Governance; Corporate Social Responsibility; Related Party transactions; Mergers & Acquisitions; Secretarial standards; Investor protection etc.

The broadening base of company secretaries gives a clear indication that in near future the company secretaries are going to become an indispensable human capital of an organization. Said this, it becomes essential at this juncture to discuss some key aspects or developments pertaining to new Companies Act, 2013 to form a concrete view how it acted as a catalyst in making the career trajectory of a company secretary to move northwards. In the ensuing paragraph a brief discussion on Financial Statements; Audit & Auditors; Secretarial Standards; Corporate Social Responsibility and Insider trading and prohibition on Forward dealings have been dealt. However, it is to be noted that every new addition and amendment in the new Companies Act, 2013 opens up avenues of opportunities for a company secretary, but due to certain technical constraints the discussion is restricted to the above mentioned points only.

- (i) *Financial Statements* : The Companies Act, 2013 states that both SFS (Standalone Financial Statement) and CFS (Consolidated Financial Statement) of all companies (including banking companies) to be signed atleast by the Chairperson of the company if he is authorized by the board, or by two directors out of which one will be Managing Director and the Chief Executive Officer, if he is a director in the company. But the most striking feature is that now a Company Secretary is also authorized to sign the financial statement, if appointed. It gives a clear indication that they are now in the mainstream of the business activities, as signing the financial statement implies perusing the same thoroughly and developing a comprehensive view regarding how various divisions or departments or units or subsidiaries are functioning, i.e. it will help a CS to form an opinion regarding the sustainability or financial viability of a particular unit/division/branch etc. Moreover, a company secretary now need to ensure that a company having one or more subsidiaries positively prepare CFS in addition to SFS, which was earlier not mandatory neither under the Companies Act, 1956 nor AS 21.
- (ii) *Audit & Auditors* : A significant development under Companies Act, 2013, pertains to formation of '**Audit Committee**'. **All companies for whom auditor is mandatory, are required to follow the recommendations of the audit committee before appointing an auditor.** Another eye-catch development in this regard, is '**Rotation of Auditors**', meaning thereby that listed companies and companies belonging to prescribed class of companies will not appoint or re-appoint the auditor for: a) More than two terms of five consecutive years, if the auditor is an audit firm and b) More than one term of five consecutive years if the auditor is an individual.

Apart from this, the auditor who has completed his term, will be ineligible for re-appointment as auditor in the same company for five years from completion of the term.

Thus, a company secretary needs to be vigilant in order to ensure that a company religiously adheres to the rules laid down relating to auditors and their rotation. A company secretary also needs to keep a close watch regarding the services provided by an auditor, i.e. new Companies Act, 2013 clearly states that any services to be rendered by the auditor should be approved by the board of directors or the audit committee.



Apart from financial audit, secretarial audit is a prominent feature that has added wings to a company secretary. Now listed companies and other class of companies as may be prescribed, the new Companies Act, 2013 have made secretarial audit mandatory.

- (iii) *Secretarial Standards* : The new Companies Act, 2013 states that every company is required to adhere secretarial standards specified by the Institute of Company Secretaries of India with reference to general and board meetings [Section 118(10) of 2013 Act], which till now were not given cognizance under the Companies Act, 1956. The need for secretarial standards arise from the fact that companies follow varied secretarial practices and, thus, there is a need to integrate, synchronize and standardize such practices in order to encourage uniformity and consistency. Insertion of this requirement in the Act is one of the landmark development for the profession of company secretaries. The justification for compelling adherence to non financial standard would ensure that all companies embrace uniform practice in convening the meetings, agenda items which must be placed before the board and finalization of the minutes etc. It is considered that the minuscule compliance and good governance can be ensured if the companies adhere to the secretarial standards effectively.
- (iv) *Corporate Social Responsibility* : The Companies Act, 2013 have invested serious efforts to inculcate the culture of corporate social responsibility (CSR) among the corporates by requiring companies to frame a corporate social responsibility policy which shall clearly display the activities to be undertaken by the company as specified in Schedule VII. Now every company having net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during any financial year shall form a Corporate Social Responsibility Committee of the Board comprising of three or more directors, out of which one director shall be an independent director.

The CSR has broadened the scope of company secretaries in terms of ensuring that corporates do discharge their due obligations towards the society, thereby, playing the twin role of a governance professional and responsible citizen of the country.

- (v) *Insider trading and prohibition on forward dealings* : The Companies Act, 2013 for the first time have defined 'Insider trading and price-sensitive information'. It prohibits any person including the director or key managerial personnel from embracing insider trading (Section 195 of Companies Act, 2013). Further, the Act also prohibits directors and key managerial personnel from forward dealings in the company or its holding, subsidiary or associate company [section 194 of Companies Act, 2013]. It has added a new dimension to the role of a company secretary, as a close vigil on the insider trading and forward dealings related activities will go a long way in curbing financial scams.

The Voyage Ahead

The new Companies Act, 2013 have provided a broad repertoire of opportunities to company secretaries but will they be really governing the organizations or they will be limited to preaching corporate governance? It is a big question for us. They have traversed long from being a clerk to governance professional but to take it forward they have to raise to the challenges that a business environment is offering on a continuous basis. In order to attain the glorified height much will depend upon knowledge, experience and expertise. With every passing day the business environment is becoming dynamic and it demands higher level of proficiency on the part of company secretaries.



Moreover, the corporate world is undergoing a metamorphosis, i.e. from profit oriented organizations; hard core capitalists to socially responsible corporate citizens; obscure dominion to well governed transparent organizations and this transmutation is going to be a never ending process. This calls for a comprehensive approach on the part of company secretaries.

Another area of botheration is medium to not so big enterprises hesitate to employ team of company secretaries due to paucity of financial resources. Generally, such organizations hire a company secretary with or without experience to perform all odd tasks related to legal and secretarial function with additional expectation to look into financial matters or issues of some other department. Still there are organizations who consider company secretary as a burden rather than a valuable asset till they don't come across legal hurdles.

The Companies Act, 2013 is a blessing and now company secretaries have to demonstrate their indispensability by enhancing their level of competence, so that organizations which currently either deliberately or obviously undermines their value will have to bring a drastic change in their approach and accept the fact that they are not burden but the fulcrum of an organization.

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GENDER DIVERSITY – DOES IT REALLY MATTERS

RANJITH KRISHNAN*

Why Gender diversity is required

Board of Directors make decisions that can impact you, your community, and the country. That's why it's important that membership on corporate boards be representative of a company's constituents. Board of directors has to choose the Key Managerial Personnel. They make decisions about executive compensation, whether to buy, sell, or merge with other companies, where corporate offices close and relocate, and how much priority a company gives to issues other than profits, such as social responsibility.

Good corporate decision-making requires the ability to hear and consider different points of view, which comes from people who have different backgrounds, experiences, and perspectives and have independent views and opinion. Companies that have women directors and executive officers lead by example. They send a clear message that they value diversity of thought and experience. Advancing women to positions of leadership is smart business.

Diversity of Thought : Women on boards bring different perspectives to the difficult issues facing today's corporations. It is widely believed that diversity of thought result in better decision making.

Stakeholder Representation : The makeup of corporate board of directors should be representative of the company in which it governs: shareholders, employees, and customers. **Competitive Advantage**: A diverse board is better positioned to thrive in today's global economy where the pace of change is accelerating and rapidly changing economic realities require nimble, strategic and well informed directors.

Availability of Essential Skills : Senior women executives offer the skills and experience that most board need, including industry knowledge, operational experience, and functional expertise.

There are studies which goes on to show that why gender diversity is important

A recent study by a group of researchers led by Kai Li of Sauder School of Business Office at the University of British Columbia, titled Director Gender and Mergers and Acquisitions, published in the Journal of Corporate Finance, suggests that the presence of women directors on company boards has substantial positive effects on maintaining firm value. It says the more women on a corporate board the less a company pays for its acquisitions. The study shows that the cost of a successful acquisition is reduced by 15.4% with each female director added on a board. It also reveals that each additional **female director reduces the number of a company's attempted takeover bids by 7.6%**. The researchers attribute this to the fact that women tend to be less interested in pursuing risky transactions and require the promise of a higher return on investment. The findings are significant as numerous studies have shown that mergers and acquisitions have failed to create value for shareholders. The researchers analysed the sample of acquisition bids made by S&P 1500 companies and examined the bid premium—the difference between the final offer price and the stock price of the firm being acquired before the deal was signed. These figures were then correlated with the number of women directors on various boards. The results were significant.

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Women hold just a small number of corporate board seats

In 2013, the 2020 Women on Boards Gender Diversity Index of Fortune 1000 companies showed that 16.6% of corporate directors were women. This is a small number when you consider that: women comprise about half of the total U.S. workforce; hold half of all management positions; are responsible for almost 80% of all consumer spending; and account for 10 million majority-owned, privately-held firms in the U.S., employing over 13 million people and generating over \$1.9 trillion in sales.

According to a study by Prime Database, two-thirds of the companies listed on National Stock Exchange of India Ltd. do not have even one woman director on their boards.

Gender Diversity and Corporate Performance

Gender diversity within senior management teams has become an increasingly topical issue for three related reasons. First, although the proportion of women at board level generally remains very low, it is changing. Based on our numbers, only 41% of MSCI ACWI stocks had any women on their boards at the end of 2005, but this had increased to 59% by the end of 2011. Second, government intervention in this area has increased. In the past five years, seven countries have passed legislation mandating female board representation and eight have set non-mandatory targets. Third – and most interesting – the debate around the topic has shifted from an issue of fairness and equality to a question of superior performance. If gender diversity on the board implies a greater probability of corporate success, then it would make sense to pursue such an objective, regardless of government directives.

There has been considerable research on the impact of gender diversity on business. This particular report addresses one key question: does gender diversity within corporate management improve performance? While it is difficult to demonstrate definitive proof, no one can argue that the results in this report are not striking. In testing the performance of 2,360 companies globally over the last six years, our analysis shows that it would on average have been better to have invested in corporates with women on their management boards than in those without. In this report they found that companies with one or more women on the board have delivered higher average returns on equity, lower gearing, better average growth and higher price/book value multiples over the course of the last six years.

There is not one easy answer to why gender diversity matters. While the facts and data presented are objective, the interpretation of the results carries more than an element of subjectivity. They analyzed the academic literature in this area and conducted several interviews with several experts on the topic. Among these, we want to thank Professor Katherine Phillips (Paul Caello Professor of Leadership and Ethics at Columbia Business School) and Professor Iris Bohnet (Academic Dean and Professor of Public Policy at the Harvard Kennedy School and now a Director on the Credit Suisse Group Board). With their help, identified seven possible explanations that, on a stand-alone basis or in some combination, help explain their findings.

The study identified seven key reasons why greater gender diversity could be correlated with stronger corporate performance:

1. *A signal of a better company* - There is a significant body of research that supports the idea that there is no causation between greater gender diversity and improved profitability and



stock price performance. Instead the link may be the positive signal that is sent to the market by the appointment of more women: first because it may signal greater focus on corporate governance and second because it is a sign that the company is already doing well. The significant size bias that we found in our own analysis of the MSCI ACWI, universe also supports the idea that it is mostly the larger companies that, to some extent by definition, have already performed well, that are more likely to appoint female board representatives. However, the strong outperformance of companies with women on the board, even in an exclusive comparison of the large caps, suggests there may be other facets to the relationship.

2. *Greater effort across the board* - Other evidence suggests that greater team diversity (including gender diversity) can lead to better average performance. Professor Katherine Phillips (Paul Caello Professor of Leadership and Ethics at Columbia University) and her colleagues have studied the impact of greater diversity in team exercises and found that :
 - (a) individuals are, on average, likely to do more preparation for any exercise that they know is going to involve working with a diverse rather than a homogenous group;
 - (b) that a wider range of available data inputs are likely to be debated in a diverse rather than a homogenous setting; and
 - (c) that the diverse group, in the end, is more likely to generate the correct answer to a particular problem than is the case for the homogenous group. In conclusion, it is not necessarily the performance of the minority individuals that have enhanced the result. Rather, it is the fact that the majority group improves its own performance in response to minority involvement. Simply put, nobody wants to look bad in front of a stranger. Hence, the greater the effort and attention to detail, the better average outcome in a more diverse environment.

In another fascinating study, Woolley et al (2010) provided evidence that the collective intelligence of a group was not mostly determined by the average or maximum intelligence of the individuals within the group but was better explained by the style and type of interaction between the group members. Specifically, the authors showed that the collective group intelligence was higher when :

- (a) the social sensitivity of the individual group members was higher;
- (b) where there was a more even distribution in the conversation between individual group members (rather than having the conversation dominated by one or two people); and
- (c) **when there were more women in the group. The three explanations aren't mutually exclusive:** specifically, this test and other work has shown that women are typically more socially sensitive (identified as **better at reading other people's thoughts**) than men. Hence, by virtue of having a greater proportion of women in the mix, the social sensitivity of the group is naturally likely to be higher.

In other words the message is that, on average, most individuals in a working group will have something to offer (information, context, experience, processing powers) and provided each member of the group is given a chance to share their knowledge, the outcome for the team is likely to be greater than the sum of the parts. In practical terms, the key takeaways are :



- (1) good management should allow group members a chance to voice their ideas to the rest of the team; and
- (2) gender diversity may be one way of skewing the sample in favour of this optimal outcome. From a corporate perspective, this also has to be the outcome that is most likely to be aligned with maximizing profit.

By definition, profit is the economic value-added generated by combining various inputs at cost. If the team result is better than the sum of the individual inputs, then it stands to reason that the team has added value. The drawback in these examples (even in the simulated situations of the laboratory) is that diversity may bring greater tension and conflict to the decision-making process. Phillips et al showed that even though the diverse groups were more likely to produce a better result than the homogenous teams, their confidence in that result was lower and the working environment was perceived to be more difficult. Indeed, other studies (Jackson et al) have shown that the effects of conflict, poor communication and distrust can outweigh the potential positives brought on by different points of view. Ultimately, this is the challenge for management: to harness the positives of diversity while avoiding the pitfalls.

3. *A better mix of leadership skills* - McKinsey has looked at the impact of greater gender diversity in the workplace in a series of reports produced over the last five years. In "Women Matter 2" produced in 2008, they highlighted the differences in male and female leadership styles. The crux of the argument was that there are nine key criteria that, on average, define any good leader. Interestingly, women apply five of these nine leadership behaviours more frequently than men. For instance, women were found to be particularly good at defining responsibilities clearly as well as being strong on mentoring and coaching employees. Men were much better at taking individual decisions and then corrective action should things go awry. Hence, the idea that a degree of gender diversity at the board level would foster a better balance in leadership skills within the company may hold merit. NASA has completed various studies on the impact of mixed gender crews. Similar to the McKinsey conclusions, women's leadership styles have been characterized by task orientation, mentoring others, and concern with the needs of others. All male expeditions, on the other hand, have been characterized by competitiveness and little sharing of personal concerns. According to NASA, crew members have reported a general sense of "calmer missions" with women on board. Plus, 75% of male crew members also noted a reduction in rude behaviour and improved cleanliness (no bad thing when packed into a confined space for a long period of time.)
4. *Access to a wider pool of talent* - Across the majority of markets, women now account for the greater proportion of graduates. Data from the UK show that, in the national examinations (GSEs) taken by the majority of 16-year-old students in 2011, 26.5% of girls achieved at least one of the top two grades whereas only 19.8% of boys achieved a top grade. Similar trends have been witnessed across much of the Western world, where school retention rates have moved higher for girls than boys over the course of the last ten years.

Hence, any company that achieves greater gender diversity is more likely to be able to tap into the widest possible pool of talent implicit in these graduation statistics. We note that the statistics haven't always been skewed towards higher female grades. If the average board member is 50 years old, it is arguably more relevant to consider the graduation rates of 25–30 years ago (i.e. 1982 to 1987). However, as an explanation for weak gender diversity in the



boardroom now, it is far from conclusive. According to UNESCO, male and female tertiary graduation rates for North America and Western Europe hit parity in the early 1980s and have continued to move up in favour of higher female graduation rates since.

5. *A better reflection of the consumer decision-maker* - If we assume that women are, on average, likely to be more responsible for household spending decisions, it could follow that a corporate board with female representation may enhance the understanding of customer preferences. According to a book published by Boston Consulting Group in 2010, 73% of US household spending decisions are controlled by women. Not surprisingly, consumer-facing industries already rank among those with the greater proportion of women on the board. Basic materials and industrial companies rank among the lowest in terms of female board representation.
6. *Improved corporate governance* - Following the scandals at several large corporate in the late 1990s, the Sarbanes-Oxley Act of 2002 in the USA and the Higgs Review of Corporate Governance in 2003 in the UK called for significant changes to the composition of corporate boards. Both called for greater balance on the board to offset the relative lack of independent advice and to reduce the homogeneity of the directors. There is unusually strong consensus within academic research that a greater number of women on the board improve performance on corporate and social governance metrics. A study of Canadian companies (listed and unlisted) by Brown and Anastasopoulos in 2002 entitled *Not Just the Right Thing, but the "Bright" thing*, showed that boards with three or more women performed much better in terms of governance than companies with all- male boards. The study also found that the more gender-diverse boards were more likely to focus on clear communication to employees, to prioritize customer satisfaction, and to consider diversity and corporate social responsibility.

One research (2010) conducted by Harvard Business School demonstrated similar results. Adams and Ferreira also suggest that gender diversity improves the performance of firms with weak governance but, on the downside, they point out that for firms where governance is already strong, greater gender diversity leads to "over-monitoring" which interferes with efficient management and could lead to reduced profits and adverse stock price movements. As with everything, it seems to be a question of achieving the right balance.

7. *Risk aversion* - In research published in 2001, Odean and Barber showed that women tended to be much more risk averse investors than men. Felton et al (2003) demonstrated that particularly optimistic men added to investment volatility: their portfolio performance was more likely to be extreme, whether great or extremely poor. Meanwhile, the same result did not hold true for women: there was no difference in investment style between more or less optimistic women. Women just remained more risk averse regardless of their outlook. Other research corroborates these conclusions.

A report compiled by Professor Nick Wilson at Leeds University Business School showed that **having at least one female director on the board appears to reduce a company's likelihood of becoming bankrupt by 20%**, and that having two or three female directors lowered the likelihood of bankruptcy **even further**. Professor Wilson went on to state that **"the negative correlation between female directors and insolvency risk appears to hold good, irrespective of size, sector and ownership, for established companies as well as for newly incorporated companies."** Analysis of the MSCI AC World constituents showed that companies with women at board level are more likely to have lower levels of gearing than their peer group where there are no women on the board. We note that lower relative debt levels have been a useful



determinant of equity market outperformance over the last four years. Lower gearing has delivered average outperformance of 2.5% per annum over the last 20 years and 6.5% per annum over the last four years (within European listed equities). It is far from a consistent determinant of performance: in periods of rapid economic expansion and equity bull markets, low gearing is often an underperforming style. Nevertheless, on average, the style has worked well and the inverse correlation between female management and risk aversion (or debt) is notable.

Good Corporate Governance

Diversity in true sense of the word is required from the point of view of strategies, approach, and finding solution to problems but not in terms of gender.

Very well said by **Melanie Wadsworth** (partner at Faegre Baker Daniels) "Diversity is not about quotas, but about ensuring that the board has a complementary and balanced set of skills and that all individuals feel able to express their views freely and effectively. The qualities which make up a **diverse board are not necessarily male or female.**" "Diversity is important, not as an end in itself, but to help create value for shareholders. There is no doubt that many women have qualities and perspectives that would enhance any board. Those same qualities – including emotional intelligence, a strong sense of responsibility and an ability to see both sides – are also demonstrated by many men. So, as we continue to feel the after-effects of financial crisis and reflect upon the **corporate governance failures in some of our largest banks, let's not forget the wider corporate governance debate about board effectiveness.** Regardless of how many female directors it may have, a board will only succeed if it also comprises fully engaged non-executives with relevant experience and a strong executive team led by a CEO who encourages and responds to being challenged. To think that there is a magic number of women who can make everything all right is a lovely idea, but ultimately misses **the point.**"

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WHY NFRA IN THE COMPANIES ACT 2013 ? AN INTERNATIONAL AND NATIONAL PERSPECTIVE

NISHITA SINGHAL*

INTRODUCTION

Auditors play a crucial role in the nation's financial system. Auditors are appointed by the shareholders to act independently in checking the accounting system of business and system of internal controls and to ensure that organizations are maintaining accurate and honest financial records and statements. Shareholders delegate the day to day management of companies to directors and because of this separation of ownership from control shareholders need independent people to check if the directors are discharging their stewardship responsibilities properly. It is an established rule that the auditors should play a vigilant and objective role in ensuring that the shareholders' interests are protected and that the management of the company have acted well within reason.

Auditors should discharge their duties objectively and independently. The auditors should also ensure that the accounts show a true and fair view of the business financial affairs. This means the profit and loss account, the balance sheet, the cash flow statements, and the notes to accounts show **and report a true and accurate picture of the business' financial performance, financial position, and financial adaptability.**

As the watchdogs of corporate accounting, they are supposed to protect investors. But after a series of spectacular failures and accounting scandals at large conglomerates like Enron, WorldCom etc. **the need for regulating auditors and audit firms was felt. In early 2001, Enron's stock had soared 90 percent of the previous year, but the means through which the company generated revenue remained opaque. Ultimately, deep accounting discrepancies, public disclosure irregularities, and general fraud proved to be the primary drivers for the company's apparent growth. Following Enron's implosion in 2001, WorldCom, assailed by similar internal accounting irregularities and fraud. It also collapsed and destroyed billions of dollars of shareholder value. The most prestigious international accounting firm in the world Arthur Andersen whose client base included high flying companies such as Enron and WorldCom was convicted in a US federal court and failed in June 2002. It was convicted of the crime of obstructing justice by shredding working papers related to Enron audits because Andersen personnel knew that the papers would be evidence in investigation. Arthur Andersen received the ultimate punishment of being forced into bankruptcy by the market, and became a negative example for other major accounting firms.**

Consequently, the US drafted new regulations like Sarbanes Oxley Act (SOX), 2002 and new auditing standards like Statement on Auditing Standard (SAS) 99 of 2002 which set new enhanced standards for all public companies and accounting firms in the US.

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The Sarbanes-Oxley Act introduced a number of new regulations to provide financial transparency in capital markets with respect to publicly-traded companies. The Sarbanes-Oxley Act was designed to "protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws." The Act provided for new levels of auditor independence; personal accountability for CEOs and CFOs; additional accountability for corporate boards; increased criminal and civil penalties for securities violations; increased disclosure regarding executive compensation, insider trading and financial statements; and certification of internal audit work by external auditors. It required audit committees, independent of management, for all listed companies and the independent audit committee, rather than management, to be directly responsible for the appointment, compensation and oversight of the external auditor. It also required audit firms to disclose certain information about their operations for the first time, including names of clients, fees and quality control procedures. It established protection for whistleblowers employed by public companies who report accounting, auditing and internal control irregularities. It required management to assess the effectiveness of internal controls over financial reporting.

The Sarbanes-Oxley Act enhanced independence of auditors by prohibiting audit firms from providing certain non-audit services to audited companies. It required lead audit partner rotation every five years rather than seven years.

One of the most significant contributions of the Sarbanes-Oxley Act was the formation of the Public Company Accounting Oversight Board (PCAOB), which assumed responsibility for overseeing the auditors and audit firms of public companies to address the growing concern of the stakeholders. The detailed requirements for how management must conduct its assessment and what standards external auditors must use in deciding whether they can sign off on that assessment was hammered out under the Public Company Accounting Oversight Board (PCAOB). The SOX provided the PCAOB with inspection, enforcement and standard-setting authority. Thus, the first major financial crisis of this millennium was the primary catalyst for the PCAOB's creation.

PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD (PCAOB)

The Sarbanes-Oxley (SOX) Act of 2002, which created a private-sector, non-profit corporation called the PCAOB, ended more than 100 years of self-regulation by the public company audit profession. It is perhaps the most fundamental change made by the SOX. The Act required that auditors of U.S. public companies be subject to external and independent oversight for the first time in history.

Today, it is the PCAOB, not the profession, which regulates audit firms, establishes auditing and ethics standards and conducts audit quality inspections. PCAOB identifies issues related to audit quality, investigates allegations and disciplines auditors of public companies and broker-dealers.

The PCAOB oversees accounting professionals who provide independent audit reports for publicly traded companies to protect investors and the public interest by promoting informative, accurate, and independent audit reports. The PCAOB also oversees the audits of broker and dealers, including compliance reports filed pursuant to federal securities laws, to promote investor protection. The PCAOB's responsibilities include the following:

- registering public accounting firms;



- establishing auditing, quality control, ethics, independence, and other standards relating to public company audits;
- conducting inspections, investigations, and disciplinary proceedings of registered accounting firms; and
- enforcing compliance with Sarbanes-Oxley.

The Securities Exchange Commission (SEC) has oversight authority over the PCAOB, including the approval of the PCAOB's rules, standards, and budget. The SEC has the authority to oversee the PCAOB's operations, to appoint or remove members, to approve the PCAOB's budget and rules, and to entertain appeals of PCAOB inspection reports and disciplinary actions. The five members of the PCAOB Board, including the Chairman, are appointed for five-year terms by the Securities and Exchange Commission (SEC), after consultation with the Chairman of the Board of Governors of the Federal Reserve System and the Secretary of the Treasury.

Some of the basic functions and powers of PCAOB are given below.

- The PCAOB has the authority to set standards governing how auditors conduct audits of public companies and broker-dealers; auditor ethics and independence; and an audit firm's system of quality control.
- The PCAOB inspects registered audit firms at intervals based on the number of public companies that the firm audits. Firms that perform annual audits of more than 100 companies are inspected annually, while other firms are inspected at least once in three years.
- The PCAOB's disciplinary powers include the authority to impose fines on individual auditors or the audit firm, revoke an audit firm's registration with the PCAOB and bar an individual auditor from association with registered audit firms.
- It can also punish firms and auditors that do not cooperate with PCAOB investigations and inspections and may refer matters to the SEC and other relevant authorities.
- The PCAOB publishes its settled and adjudicated disciplinary orders on its website to alert the public about the actions it has taken and warns the public against whom the action has been taken.

The PCAOB's standard-setting initiatives and inspections have contributed significantly to improvements in audit quality and auditor independence and consequently affording investors significant benefits. As of December 31, 2011, over 2,000 audit firms from more than 80 countries were registered with the PCAOB. In 2011, it conducted inspections of 213 registered audit firms, and initiated an interim inspection program for broker-dealers.

Between 2005 and 2011, the PCAOB publicly announced the resolution of 45 enforcement actions and 31 disciplinary actions. The cases announced by the Board in 2012 includes a number of proceedings alleging serious audit failures relating to audits of public companies including a case against a "Big Four" accounting firm and several of its partners that imposed a \$2.0 million fine against the firm in connection with repeated violations of professional standards. Recently, in October 2013 the Public Company Accounting Oversight Board has censured Deloitte & Touche and fined the firm \$2 million, accusing the firm of allowing a barred audit partner to continue to perform prohibited audit work.



However the effectiveness of PCAOB is still a big question. The board has been little successful in regulating the auditors. Eight years after the formation of the PCAOB, financial crisis of 2008 occurred that shook the financial stability of all big economies in the world. The wave of accounting scandals that devastated share prices and destroyed the accounting firm 'Arthur Andersen' years ago raised a question on the value of the audits. Today, the remaining Big Four accounting firms are regarded as potentially "too big to fail." Though along with other watchdogs, auditors did not prevent the financial crisis of 2008. At subprime lender New Century Financial, KPMG auditors acquiesced in New Century's departures from prescribed accounting methodologies and at times acted more as advocates for New Century. At Lehman Brothers, the investment bank that collapsed in 2008 had used an accounting device to remove tens of billions of dollars of assets from its balance sheet. The PCAOB examiner Anton R. Valukas faulted auditor Ernst & Young for, "among other things, its failure to question and challenge improper or inadequate disclosures." The auditors virtually took no action to investigate.

In response to the Financial Crisis of 2008, the Federal government established the Financial Crisis Inquiry Commission to investigate the causes of the meltdown in domestic and global lending. The Commission published an extensive report exploring several interconnected explanations for the Financial Crisis, including failures in financial regulation, excessive borrowing, overly risky investments, over-the-counter derivatives markets, and the government's incapacity to react.

Then the new Act "Dodd-Frank Wall Street Reform and Consumer Protection Act" was formed primarily motivated by the Financial Crisis of 2008. It enhanced the regulatory powers of the PCAOB. The Dodd-Frank amendments to the mandate of the PCAOB fall into three general categories. First, under Sarbanes-Oxley, the PCAOB did not regulate the auditors of securities brokers and dealers. Now, the Board has the authority to investigate and discipline broker-dealer auditors. Second, the PCAOB has new authority to share information with foreign audit oversight boards. Third, the PCAOB, in conjunction with the SEC to make rules which govern accounting firms and standards.

The PCAOB was empowered to rewrite standards for auditors but the board has made little use of that power. The old standards written by the auditing industry to insulate auditors from liability, for the most part remain unchanged. When auditors are suspected of negligence or complicity in cooking corporate books, PCAOB enforcement cases can take several years to resolve. In 2009, the board disciplined a former Deloitte & Touche auditor for misconduct that allegedly took place more than five years earlier. In the meantime, even the fact that the board is investigating is concealed from the public.

The PCAOB has to face many restrictions under the Sarbanes-Oxley also. Some of them are highlighted below-

- **The Act limits PCAOB's ability to publicize enforcement actions** against registered public accounting firms or their associated persons. The PCAOB is not authorized to make its enforcement proceedings public until the parties consent to a public hearing, the PCAOB has imposed sanctions and the time to file an appeal with the Securities and Exchange Commission has expired, or the SEC, on appeal, issues an order regarding the sanctions imposed. These restrictions create an incentive for respondents in enforcement cases to contest the PCAOB's allegations and appeal adverse decisions in order to delay publicity about the proceedings. The PCAOB has not been able to persuade Congress to amend Sarbanes-Oxley to allow the Board to



announce when it has commenced a disciplinary proceeding against a registered public accounting firm or an associated person.

- Under Sarbanes-Oxley and the Board's rules, registered public accounting firms and their associated persons must cooperate with requests for information from the Board's Inspection or Enforcement Staffs. This obligation includes the responsibility, when requested, to provide the PCAOB Staff with access to audit work-papers and related documentation on a timely basis that accurately reflects the work performed before issuing an audit report on an issuer's or registered broker-dealers' financial statements or internal controls. But in many cases it has found that a registered public accounting firm fails to cooperate with the Board's Inspection Staff or Enforcement Staff, or provides the Staff with altered or misleading audit documentation.
- Since its creation, the PCAOB has met with opposition from some foreign governments, including China and certain countries in the European Union. Citing concerns about national sovereignty or compliance with local laws, these countries have not permitted the Board to conduct inspections of PCAOB-registered firms in their jurisdictions. Thus, the PCAOB is unable to obtain access to work-papers relating to audits of foreign companies that have securities registered in the United States.

The board is making a meaningful contribution to investor protection but still faces a variety of challenges to realizing fully the audit oversight. The Board inspectors find serious lapses at audit firms but the reports describe those shortcomings in opaque terms, they don't name the companies that were improperly audited. Most of the board's announced disciplinary actions have involved small audit firms that are not as equipped to fight back as the big accounting firms that generally audit the largest companies. For example - an auditor of a Big Four firm, auditing large corporation was disbarred for allegedly backdating records. Two years after disciplining him, the board reinstated his right to audit public companies. Thus, the board will have to aggressively improve its auditing standards, inspections and enforcement rules and procedures.

WHY NFRA ?

In recent times India has faced several issues related to auditors that had led to various accounting frauds, including in the case of high-profile Satyam Computer Services Ltd. wherein the founder and **then chairman of Satyam Computer had admitted that the company's accounts had been falsified for years**, although the auditors did not notice any accounting fraud. Later, the company auditors were also found to be guilty in that case during various investigations into what emerged as the country's biggest ever corporate fraud.

More recently, it was reported that PwC, the auditors of Satyam Computer Services Ltd had to pay \$25.5 million (Rs 114 crore) to compensate investors of Satyam in the United States who suffered losses in the scandal. Though investors across the globe were compensated, Indian investors were left out; one of the reasons may be that there is no oversight body like PCAOB in India. In an order dated 5 April 2011, **the SEC said Price Waterhouse's audit reports on Satyam "did not conduct Satyam's audits in accordance with PCAOB (the US Public Company Accounting Oversight Board) standards...** Specifically, the PW India partners and staff on the Satyam engagement team failed to maintain control of the confirmation process with respect to cash and cash equivalent balances as well as **Satyam's accounts receivables. The failure to properly execute third-party confirmation procedures resulted in the fraud at Satyam going undetected until the former chairman's public confession in**



January 2009.” Further: “The respondents (PW) failed to identify the material overstatement of Satyam’s assets, in part, because the engagement team failed to carry out the confirmation processes and procedures related to cash and interest-bearing deposits in accordance with PCAOB standards — and its own audit plan — for fiscal years 2005-2008. PCAOB standards require, among other things that auditors test the existence and valuation of reported cash and **interest bearing deposit balances.**” The SEC concluded that the auditors were in league with the Satyam management and the fraud could not have happened without the auditors knowing about it, so they were penalised.

The Report of 21st Parliamentary Standing Committee (PSC) on Finance recommended setting up of oversight body to set standards & supervise quality of audit. The guiding principle stated was “In the light of recent experiences in corporate mis-governance, process of audit and functioning of auditors to be made more independent and effective; stringent joint and individual liability prescribed; setting up of oversight body to set standards and supervise quality of audit recommended.”

International Organization of Securities Commissions (IOSCO) an association of bodies that regulate world’s securities & futures markets formulated 8 new principles in June 2010 to ensure that systemic risks were reduced & markets functioned fairly, efficiently & transparently. One of the key principles was that 'auditors should be subject to adequate levels of oversight by an authority that is independent of the audit profession'. SEBI is a member of IOSCO and SEBI also proposed that an oversight mechanism created quickly in line with requirements of new global rules.

FORMATION OF NFRA

In order to look into the matters relating to accounting and auditing standards similar to the PCAOB in the US, the Companies Act 2013 has introduced a new provision which provides for the formation of National Financial Reporting Authority (NFRA). NFRA is supposed to supervise large companies to avert Satyam-like frauds. It will also be responsible for setting up accounting and auditing standards and also disciplining the profession. NFRA will have the powers to act against audit firms as well.

The National Financial Reporting Authority will be headed by a chairperson, who shall be a person of eminence and having expertise in accountancy, auditing, finance or law to be nominated by Central Government & maximum 15 other part-time and full-time members. The head office will be at New Delhi & and the Central Government may appoint secretary & other employees for performance of functions by NFRA. Its accounts shall be audited by CAG & such accounts as certified by CAG together with audit report shall be forwarded annually to Central Govt.

OBJECTIVES AND FUNCTIONS OF NFRA

The NFRA will consider International Financial Reporting Standards (IFRS) & other internationally accepted accounting & auditing policies and make recommendations to the Central Government which will improve competitiveness of Indian companies with other international companies.

It will make recommendations to the Central Government on the formulation and laying down of accounting and auditing policies and standards for companies or their auditors. It will also monitor and enforce the compliance with accounting standards and auditing standards and oversee the quality of service of the auditors and audit firms and suggest measures required for improvement in the quality of service of such auditors.



POWERS OF NFRA

The NFRA will have quasi judicial powers to ensure independent oversight over professionals. The Act empowers the NFRA to oversee the quality of service of the professionals associated with ensuring compliance with accounting and auditing standards. It also empowers NFRA to suggest measures required for improvement in the quality of services provided by such professionals.

It will have the power to investigate, either suo-moto or on a reference made to it by the Central Government into the matters of professional or other misconduct committed by any member or firm of chartered accountants, registered under the Chartered Accountants Act, 1949.

NFRA will have the same powers as are vested in a civil court under the Code of Civil Procedure, 1908, while trying a suit, in respect of the following matters-

- discovery and production of books of account and other documents
- summoning and enforcing the attendance of persons and examining them on oath
- inspection of any books, registers and other documents
- issuing commissions for examination of witnesses or documents.

The NFRA will be empowered to impose fine and penalty of minimum one lakh rupees to five times of the fees received in case of individuals and ten lakh rupees to ten times of the fees received in case of firms.

It can also debar the member or the firm from engaging himself or itself from practice as member of the Institute of Chartered Accountant of India for a minimum period of six months or higher period but not exceeding ten years where professional or other misconduct is proved.

Nobody will be able to start any proceedings in any case in which NFRA has initiated its proceedings. Only appeal shall lie to the appellate authority against order of NFRA. Any appeal against the order of the National Financial Reporting Authority may be made before the Appellate Authority which will consist of a chairperson and not more than two other members appointed by the Central Government.

CONCLUSION

The NFRA, which is empowered like that of PCAOB to formulate standards of accounting and auditing and regulate the services provided by auditors will definitely provide a moral check on the auditors but time will only tell how effective the NFRA will be. In today's era companies are operating in more volatile, dynamic and global market conditions which will make audits increasingly complex – and even more critical to investor confidence. For this reason improvement in audit quality and strengthening corporate governance is strongly required. Professional standards that strengthen audit quality as well as the relevance, reliability and transparency of the audit process to investors are important. Achieving and maintaining audit quality will require a process of continuous improvement.

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COMPANY SECRETARY – A SOCIALLY VIGILANT PROFESSIONAL

RAKESH KUMAR*

Theme Perception

Change is constant in everybody's life, be it individual, corporate, society or government and it always presupposes to bring certain positive developments. The need for minimum government and maximum governance is one of the examples of the paradigm shift in the thought process and approach towards social welfare. It is the collective responsibility of all including the professionals, government and society to understand the language of change, appreciate it and capitalize on it to the maximum benefits of society.

Change always involves moving out of comfort zones to find the new era and generally, people resist the change due to CHALLENGES of change, which they found difficult to deal with. One may ask is it possible to turn the challenges into opportunity? The answer would be yes. It's all about our perception towards the challenges, how we respond to any situation reveals a lot about our attitude and perception. So, when we see challenges as opportunities, it means that we have a healthy degree of optimism, self-confidence and openness, along with a professional spirit. On different side, when we resist the change, it indicates a pessimistic, closed and fearful perception.

The challenges are better in a way to bring about the best out of one's ability and the Company Secretary professional being more exposed to these challenges, be ready to evolve.

Company Secretary Professional

Company Secretary as professional gatekeepers to good governance are primarily concerned with the changes in corporate and regulatory environment. The increasing awareness on corporate governance issues worldwide raised the regulators/government attention to pave the way for necessary alignment in local regulations/laws according to the demands of the society. The recent revision to corporate governance norms forming part of Listing Agreement of Stock Exchanges is one of such example.

The role of Company Secretary Professional is changing significantly towards the various stakeholders. It is increasingly outward-focused including investor engagement/ corporate communications, and not just about internal coordination and compliances.

Company Secretaries are ideally placed to align the interests of different stakeholders during the Boardroom discussion, facilitate dialogue, gather and assimilate relevant information, and enable effective decision-making. They are often the only people to know first-hand how the decisions made have been reached.

A Company Secretary as a professional certifies and verifies the trust worthiness of the affairs of a corporation. At its best, it delivers strategic leadership, acting as a vital bridge between the executive management and the board to facilitate the delivery of organisational objectives. Company Secretaries are often repository of company history and culture, and therefore necessarily a guarantor of continuity for an organization. The skills and attributes of a good Company Secretary may include

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



humanity, humility, high intelligence, understanding of agendas, negotiation and resilience. A Company Secretary being a secretary to the company has overreaching responsibility to take care of interest of all the stakeholders specially those who are not involved in the day to day affairs and management of the company.

Not only that being a part of the society, they should have conscientiousness towards the social issues and make their company socially and ethically compliant.

COMPANY SECRETARIES IN VIGILANT ROLE

Right To Information Act, 2005

The right to information is implicitly guaranteed by the Constitution. However, with a view to set out a practical regime for the citizens to secure information as a matter of right, the Indian Parliament enacted the Right To Information Act, 2005 (RTI Act) which is applicable to Government at all levels- Union, State and Local as well as to its undertakings and recipients of substantial government funds.

The basic object of the RTI Act is to empower the citizens, to promote transparency and accountability in the working of the Government, to contain corruption, and to enhance people's participation in democratic process thereby making our democracy work for the people in a real sense. It goes without saying that an informed citizen is better equipped to keep necessary vigil on the instruments of governance and make the government more accountable to the governed. The RTI Act is a big step towards making the citizens informed about the activities/functions and the decision making process of the Government.

The Public Information Officer (PIO) of a public authority plays a pivotal role in making the right of citizens to information a reality. The RTI Act casts specific duties on PIO and makes him liable for penalty in case of default. Section 5(1) of the Right to Information Act, 2005 mandates all public authorities to designate as many Public Information Officers as necessary to provide information under the Act. All public authorities with more than one PIO requires creating a RTI Cell within the organisation to receive all the RTI applications and first appeals and to route them to the concerned PIOs/First Appellate Authority, respectively.

Being an expert in the corporate laws applicable to the companies, the role of company secretaries in implementing the Right to Information Act, 2005 is quite significant. Although there are no mandatory provisions under the Right To Information Act, 2005 for appointment of Company Secretary Professionals as Chief Public Information Officer (CPIO) or Appellate Authority, still in almost every company to which the RTI Act is applicable one may find Company Secretary as performing the role either of Chief Public Information Officer or Appellate Authority. It shows the amount of trust and responsibility place on the shoulders of Company Secretary professionals towards the organization and society at large.

Since, Company Secretaries are directly or indirectly involved in effective implementation of social legislations like RTI Act, 2005 it would be pertinent for them to understand the legal and procedural aspects of the RTI Act to perform their functions effectively to better serve the society.

Whistle Blower Protection Act, 2011

Corruption is a social evil and one of the impediments felt in eliminating corruption in the Government and the public sector undertakings is lack of adequate protection to the complainants



reporting the corruption or wilful misuse of power or wilful misuse of discretion which causes demonstrable loss to the Government or commission of a criminal offence by a public servant.

A whistleblower is the one who exposes wrongdoing, fraud, corruption or mismanagement in an organization. Whistle blower may be an employee, former employee, vendor, customer or other stakeholder. Whistle blowers are important stakeholders as they can work as an aid for authorities to get information of deviant behaviour or practices in organizations.

The Whistle Blowers Protection Bill introduced on August 26, 2010, was referred to a Parliamentary Standing Committee on September 16, 2010, which had given its report on June 9, 2011. The Bill was passed by the both the houses of the parliament.

Whistle Blowers Protection Act, 2011 got the assent of the President of India on 9th May 2014 and a notification in the Official Gazette of India was issued on 12th May, 2014 to provide a system to encourage people to disclose information about corruption or the wilful misuse of power by public servants, including ministers. The law provides safeguards against victimization of the person who makes the complaint.

The Companies Act, 2013

The Companies Act, 2013 mandates to establish vigil mechanism which will enable a company to evolve a process to encourage ethical corporate behaviour, while rewarding employees for their integrity and for providing valuable information to the management on deviant practices.

According to Section 177(9) of the Companies Act, 2013 read with rule 7 of Companies (Meetings of Board and its Powers) Rules, 2014, establishment of vigil mechanism is mandatory for –

- Every listed company;
- Every other company which accepts deposits from the public;
- Every company which has borrowed money from banks and public financial institutions in excess of Rs. 50 crores.

The companies which are required to constitute an Audit Committee is to oversee the vigil mechanism through the committee and in case of other companies, the Board of directors to nominate a director to play the role of Audit Committee for the purpose of vigil mechanism to whom other directors and employees may report their concerns.

The vigilance mechanism has to be backed with adequate safeguards against victimization of whistleblowers and should provide direct access to the Chairperson of the Audit Committee or the director nominated to play the role of Audit Committee in exceptional cases.

Vigil Mechanism under Listing Agreement

The revised clause 49 of the Listing Agreement which would be effective from October 01, 2014 requires companies to establish a vigil mechanism. It states that the mechanism should provide adequate safeguards to prevent victimisation of the whistle blower. To align with the requirement of the Companies Act 2013, it significantly enhances the power of the Audit Committee entrusting it with various responsibility including the review of whistle blower mechanism.



Role of Company Secretary in Whistle Blower Mechanism

In the light of the growing corporate misgovernance, development of a legislative framework for adequate whistle blower mechanism is a move towards the right direction. Company Secretary being a secretary to the Audit Committee would be actively involved in ensuring the proper functioning of whistle blowing mechanism in the organization. The Company Secretary is primarily responsible for the efficient administration of company in accordance with the applicable laws and for ensuring that board level decisions are implemented properly and regular reporting thereon. Apart, from that Company Secretary should also oversee the impact of any such decision on stakeholders and if there is any concern, it must be reported to the management.

The cases of whistle blowing should be reported on priority to the management to take corrective action. The success of whistle blower mechanism depends upon the effective measures provided in the Whistle Blower Policy of the Company.

Recent, incidences of victimisation of Whistle Blowers shows that whistle blowers had to face harsh consequences even to the extent of losing their life. Whistle blowing as an internal control mechanism in the hands of Audit Committee and Board of Directors, ensures detection of any fraud or any concern **which might put the company's reputation at stake. Board is responsible for encouraging** whistle blowing in the organization. Where the employees are not confident of the process of whistle blowing mechanism of the company they would resist from being a part of the process.

The effectiveness of system mainly depends upon how the wrong doings reported have been acted upon while providing sufficient protection to whistle blowers.

The professionals like Company Secretaries being a bridge between the stakeholders, company's management and the Board hold the enormous responsibility in ensuring the effective implementation of Whistle blower mechanism in the company and to develop the confidence of employees in that mechanism so that they can freely report any unethical practices, fraud or concern noticed in the company.

Corporate Social Responsibility (CSR) & Sustainability

Section 135 of the Companies Act, 2013 makes it mandatory for certain class of companies to constitute a Corporate Social Responsibility (CSR) Committee of the Board with at least one independent director. While the Committee shall formulate and recommend Corporate Social Responsibility Policy of the company in line with schedule VII of the Act, the Board of directors shall required to ensure that company spends in every financial year atleast 2% of the average net profits of the company made during the three immediately preceding financial years in pursuance of its CSR policy. Where the company fails to spend such amount, the Board shall in its report specify the **reasons for not spending the amount. The approach is to 'comply or explain'.**

The Company Secretary can play instrumental role in the development of CSR values and policy for an organisation. The evolution of the relationship between companies and society has been one of slow transformation from a philanthropic coexistence to one where the mutual interest of all the stakeholders is gaining paramount importance and Company Secretary professional has lots to be done to guide the organisational synergis to the social development. In addition, a Company Secretary



also play significant role in implementation of various other laws/guidelines important from society perspective like competition laws, environment laws and Business Responsibility Guidelines etc.

CONCLUSION

The profession of Company Secretaries demands that the interest of all stakeholders is taken care of and Company Secretaries need to be vigilant over the compliance of applicable laws to the organisation in true letter and spirit. Being a socially vigilant professional, it is the duty of Company Secretaries to take care of the interest of all stakeholders and the society at large.

The Right to information Act, Whistle Blowing Mechanism, CSR and environmental laws are some of the important area where large societal interest are involved and Company Secretary professionals should remain charged up to face the challenges and grab the opportunity envisaged under these regulatory mandates.

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SOCIETY, ECONOMY AND PROFESSIONALS

SUDHIR KUMAR SAKLANI*

The economy is a fundamental part of contemporary society. Besides being a social institution in its own right, it also contributes to the administrative, educational, ethical, legal, and religious organization of society; in short, the social superstructure. The society to be the result of an economic base and a social superstructure; it is also the economic base which determines all other social structures including ideology, politics, and religion.

Economic Growth and Social Progress

Economic development and social progress are measured by different parameters. The country's economic development is measured on the basis of Gross Domestic Product (GDP) and the social progress nowadays measured in terms of Human Development Index (HDI) coined by noble laureate Amartya Sen. Capital market indices are said to be the barometer of financial health of the country and **sensex is parameter of a country's growth and progress.** But, whether the Gross Domestic Product (GDP) or the capital market indices are adequate measures of a country's development across many dimensions? Or whether actually they depict the inclusive growth of the country?

This has been debated vigorously at various fronts in recent years. The GDP focuses exclusively on economic growth and does not capture the level of inequity which can exist in a society despite overall economic growth. It pays no attention to the social and environmental measures of development which are as important as economic development. So, an index of social progress is needed which does not try to displace GDP (not yet anyway) but has additive value. Such index should also cover the objectives mentioned in the Millennium Development Goals set by United Nation and includes the economic, social and environmental factors.

There is no doubt that the economic and social progress is important for a country. These two tracks are closely interlinked and sometimes inseparable and should be on Basic Human Needs, Foundations of Wellbeing and Opportunity.

The social progress is distinct from economic development, though correlated with it; some aspects of social progress are more closely related to the level of economic development than others; countries have relative strengths and weaknesses in social progress, both across the major dimensions and across components within the dimensions.

Even as the country commits itself to move on the fast track of economic growth, it must be mindful of the need to invest in improving the social indicators as well. We may continue to measure GDP if that is still considered the talisman of economic progress, but we must also simultaneously measure social progress lest we end up as a soulless society characterised by gaping inequality and glaring social backwardness despite gaining wealth. The advantages of development should be equitably distributed to all sections of the society.

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This all posed a challenge before the professionals to cope up with the social problems while dealing with the economics of business.

Indian Economy in 21st Century

In the 21st century, India has emerged as an important global economic and political actor. India has made much progress in the area of inclusive economic growth by adopting many measures in human resource development, equitable infrastructure, short term distress mitigation, grass roots institution building, environmentally – sound strategies, and integration into the knowledge economy.

After achieving unprecedented growth of over 9 per cent for three successive years between 2005-06 and 2007-08 and recovering swiftly from the global financial crisis of 2008-09, the Indian economy has been going through challenging times that culminated in lower than 5 per cent growth of GDP at factor cost at constant prices for two consecutive years, i.e. 2012-13 and 2013-14.

In previous financial year, growth has increasingly come from the services sector. The services sector with an around 57 per cent contribution to the gross domestic product (GDP), has made rapid strides in the last few years and emerged as the largest and fastest-growing sector of the economy. **Besides being the dominant sector in India's GDP, it has also contributed substantially to foreign investment flows, exports, and employment. India's services sector covers a wide variety of activities that have different features and dimensions. Some services like IT and telecommunications are very sophisticated, involving high technology and expertise, while some are simple like those of barbers and plumbers.¹**

India's growth story with a services-led growth has been unique for a developing country. The immediate challenge in this sector is revival of growth. While this could be achieved through reforms and speeding up of the policy decision making, a targeted approach could lead to a rebounding of services-sector growth for India.

One thing is clear that the agriculture has very low productivity but employs over half the labour force. In contrast, financial and brokerage services are the most productive sector in the economy, but employ a tiny share of the labour force. While the share of employment in services has been growing very slowly, the share of value added is significantly higher.

The Indian economy is transforming itself from agrarian to industrial and to service sector. The Service Sector which will be the major sector of world economy for the rest 21st Century require more professionals like company secretaries who shall be competent to drive the economy with ease.

Opportunities for Professionals

With the growth and development in this social superstructure, the complexity of managing it has been increasing day by day. To overcome such complexities, the role of professionals is increasing.

The ever greater dependence of modern society upon professional services, there is an increase in the variety of such services and in the number of the professions. Many practitioners of older professions and for most or all of some newer professions are to serve the society and the society inter alia has to pay for the service rendered by professionals.

While the community at large is in all times and places concerned with the manner in which professional services are performed, this is especially so in our times; indeed, the community at large is the client of some new professions and, in increasing measure, of older ones.

Therefore, the professions as central feature of society, is a key to the understanding of social structure.

Importance of Professions



Herbert Spencer considered the elaboration of professions the essential feature of civilized society. Other institutions arose to defend, sustain, and regulate life.

It cannot be too often repeated that the hallmark of the professional man must be his integrity and his independence, although a professional must have regard to his client's interests and he also has a duty towards country and the community.

A profession involves a particular kind of relationship with clients arising from the complexity of the subject matter which deprives the client of the ability to make informed judgments for himself and so renders him to a large extent dependent upon the professional man. A self-imposed code of professional ethics is intended to correct the imbalance in the relationship between the professional man and his client and resolve the inevitable conflicts between the interests of the client and the professional man or of the community at large.

It must always be remembered that the work of the professionals is to help those who consult him to avoid or overcome the frustrations and difficulties that arise from potential or actual conflicts of interest, whether between individuals or between citizens and the State or some other authority.

Innovation and professionals

As rightly said by Nobel laureate Albert Einstein that imagination is more important than knowledge. The imagination leads to innovation and innovation is a critical component in improving individual and institutional performance. Real innovation is not easy to come by. More often, establishments tweak compensation systems; tinker with organisational structures; or make marginal improvements in some functions. Innovation is more radical and transformational than an improvement. Innovation is content-oriented, whereas improvement is process-oriented.

It is not possible to countenance a high and increasing standard of living merely by long-in-the-tooth tools of development. Every now and then, organisations confront situations that warrant radical changes, which call for out-of-the-box thinking. It is only through innovation that we can bring about such avant-garde transformation.

Inspiration for innovation usually stems from a combination of three factors: an urgent and nagging necessity to bring about a change; how people perceive and pursue that change to the ultimate; and a congenial environment to accomplish that change.

Innovation is always driven by self-induced passion, pressure of compelling circumstances, and undying perseverance for achievement. Globalisation itself is a product of innovation and the professionals have to be innovative which results in inclusive economic growth.

Conclusion

Moving from the known to the unknown is a different ball game altogether. Looking at the reality behind the rhetoric, and in order to derive the optimum advantage, it is essential to embrace and espouse the evolving norms, wholly and willingly. The professionals must ensure that the economic gains generated by growth are not monopolised only by the high and mighty, but the marginalised sections in the society also derive the benefits.

In nutshell, the Professionals are the Instrument of Society to achieve the social objectives. The professionals are part and parcel of social system and social superstructure. The professions can only grow on the line and set up of social norms. Apart from this, the professionals require strategies to oust the shortcomings and enhancing the socio-economic conditions of the society in the emerging environment.



CROWDFUNDING : AN EMERGING SOURCE OF FINANCE

MAHESH KUMAR AIRAN*

Prologue

Over the last 20 years, India has taken several steps to streamline and strengthen financial market regulations. SEBI regulates securities market having distinct responsibilities for regulation of the conduct of intermediaries, capital market and interaction between entities seeking to raise and invest in capital. It regulates securities market institutions such as the stock exchanges, depositories, mutual funds and asset management companies, market intermediaries- brokers, merchant bankers, credit rating agencies and venture capital funds etc.

During the last few years, the IPO market has not been very active in India. Though, SEBI, has been at the forefront in facilitating fund raising by SMEs through measures like SME segment in Stock Exchanges, Category I- SME funds under AIF, Institutional Trading Platform, etc., still there is need to encourage innovative way of fund raising to provide an impetus to genuine SMEs/Start-ups and to explore other alternative models of fund raising with appropriate framework in consonance with retail investor protection. In recent years, crowdfunding has become a valuable alternative source of funding for entrepreneurs seeking external financing.

SEBI has provided various frameworks for raising of funds by startups, SMEs, Alternative Investment Funds etc. In addition to the available frameworks, SEBI seeks to provide fresh avenues for startups and SMEs set up by young entrepreneurs and technology professionals to raise early stage funding through internet based platforms, potentially more efficiently and cost effectively than through public issue or private placement offering.

The provisions in the existing legal framework for raising funds by companies are regulated under Companies' Act 2013 and Securities Act i.e. SEBI Act, 1992, Securities Contracts (Regulation) Act, 1956, Depositories Act, 1996. Raising of pooled managed investment funds by various entities such as Alternative Investment Fund (AIF), Mutual Fund (MF) etc. is regulated under Securities Laws. To regulate crowdfunding, it is very important to take note that while it is necessary to ensure that Start-ups/SMEs could raise funds at ease, it is equally important to ensure that no systemic risks are created wherein retail investors are lured by some unscrupulous players by substituting the existing framework, which has been developed over a period of time through experience and observation. Hence, there is necessity to strike a proper balance between investor protection and the role equity markets can play in supporting economic development and growth.

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Crowdfunding: An Overview

The concept of crowdfunding is rooted in the broader concept of crowdsourcing, which refer to using the crowd to obtain ideas, feedback, and solutions to develop corporate activities. In the case of crowdfunding, the objective is to collect money for investment, generally by using online social networks. In other words, instead of raising money from a small group of sophisticated investors, **crowdfunding helps firms to obtain money from large audiences 'the crowd', in which each individual provides a very small amount.** Such investment can take the form of equity purchase, loan, donation or pre-ordering of the product.

It is well recognized that new firms face difficulties in attracting external finance during their initial stage, be it through bank loans or equity capital. Many entrepreneurial ventures remain unfunded, partly because of a lack of sufficient value that can be pledged to financial investors and partly because of unsuccessful attempts to convince investors. To circumvent these problems, new source of finance so-called **Crowdfunding have recently been employed by tapping the 'crowd' instead of specialized investors.** Crowdfunding helps entrepreneurs adopt new approaches of undertaking entrepreneurial projects and managing ventures, which in turn leads to new forms of business **development in which the 'ordinary' crowd gets more closely involved** in these firms, as active consumers, investors, or both.

Crowd-funding is an umbrella term describing the use of small amounts of money, obtained from a large number of individuals or organisations, to fund a project, a business or personal loan, and other needs through an online web-based platform. The online nature and the usually small size of investments of crowd-funding makes this industry different from private placement or other similar activities. As per IOSCO Staff Working Paper - Crowd-funding: An Infant Industry Growing Fast, 2014 ('IOSCO Paper'), Crowd-funding can be divided into four categories as under:

- I. *Donation Crowdfunding* : Donation crowdfunding denotes solicitation of funds for social, artistic, philanthropic or other purpose, and not in exchange for anything of tangible value.
- II. *Reward Crowdfunding* : Reward crowdfunding refers to solicitation of funds, wherein investors receive some existing or future tangible reward (such as an existing or future consumer product or a membership rewards scheme) as consideration.
- III. *Peer-to-Peer lending* : In Peer-to-Peer lending, an online platform matches lenders/investors with borrowers/issuers in order to provide unsecured loans and the interest rate is set by the platform. Some Peer-to-Peer platforms arrange loans between individuals, while other platforms pool funds which are then lent to small and medium-sized businesses.
- IV. *Equity based Crowdfunding* : In Equity based Crowdfunding, in consideration of funds solicited from investors, Equity Shares of the Company are issued. It refers to fund raising by a business, particularly early-stage funding, through offering equity interests in the business to investors online. Businesses seeking to raise capital through this mode typically advertise online through a crowdfunding platform website, which serves as an intermediary between investors and the start-up companies.

The first two categories i.e. Donation Crowdfunding and Reward Crowdfunding are grouped together as Community Crowdfunding and remaining two categories i.e Peer to Peer Lending and Equity Crowdfunding are collectively named as Financial Return Crowdfunding. If we talk about the benefits of crowdfunding, there are several benefits like:



- To raise funds at lower cost of capital without undergoing through rigorous procedure.
- It provides new investment avenue and provide a new product for portfolio diversification of investors.
- It increases flows of credit to SMEs and other users in the real economy.

Returns are always associated with the risks. So various risks like Retail risk , Default risk, fraud risk, Systemic risk, central role of Internet, Information asymmetry etc. are associated with this new avenue of Investment. It is necessary that the Investors who seek to invest in crowdfunding understand the inherent risks in the speculative nature of start-up companies and illiquid nature of their securities and can bear the loss of the entire investment.

Regulatory framework for Crowdfunding

In Donation crowdfunding and Reward crowdfunding, only donations or grants are solicited and no financial return in the form of a yield or return on investment is expected by the donor/grantor. Hence, such funding mostly falls outside the purview of Securities market regulator. (In India, payments of donations are mainly governed by the provisions of Income Tax Act). Peer-to-Peer lending, depending upon whether pure lending or any debt securities are issued, are regulated by Banking or Securities market regulator. Crowd Sourced Equity Funding are mostly regulated by Securities market regulator. Financial Reward (FR) crowd-funding globally has grown rapidly in the last 5 years, with data suggesting that the peer-to-peer lending market doubles each year. As per Staff Working paper of IOSCO Research Department 'Crowd-funding: An Infant Industry Growing Fast' it accounts for approximately \$6.4 billion outstanding globally. Collectively, the US, UK and China make up 96% of the overall FR crowdfunding market, with USA accounting for 51%, China for 28% and UK for 17%.

Nature of regulations concerning Peer-to-Peer lending varies with nations, as per IOSCO Paper, these can be broadly divided into different categories.

<i>Regulatory Regime</i>	<i>Description</i>	<i>Countries</i>
Unregulated	In these jurisdictions either the regulation has classified peer-to-peer lending as an exempt market or there is a lack of definition in legislation	Brazil, China, Egypt, South Korea
Intermediary Regulation	This regulates peer-to-peer lending platforms as an intermediary. This usually requires registration of such platform as an intermediary, and other regulatory requirements depending on the jurisdiction.	Australia, Argentina, Brazil, New Zealand
Banking Regulations	This regulated peer-to-peer lending platforms as banks.	France, Germany, Italy
US Model	This is a two tier system. This requires the registration of peer-to-peer lending platforms with the SEC, as well as applying for a licence to conduct business on a state by state basis.	USA
Prohibited	Both peer-to-peer lending and equity crowd-funding are banned under legislation	Israel, Japan



In case of Equity Crowdfunding, most jurisdictions have enabled it as an exemption to general requirements regarding public solicitation through prospectus/offering memorandum. While in some jurisdictions such exemption is given only to offer made to “accredited/informed/wealthiest” investors, others exempts solicitation made through “Crowdfunding Platform” capping the amount that can be raised or the amount that can be invested by each investor.

Crowdfunding Regulation in other Countries

Crowdfunding has its origins in the concept of crowdsourcing, which is the broader concept of an individual reaching a goal by receiving and leveraging small contributions from many parties. Various countries have adopted the concept of Crowdfunding for startup financing. Brief about the regulatory framework in few countries are mentioned hereunder:

United States

In April of 2012, Shri Barack Obama, President, United States signed the Jumpstart Our Business Startups (JOBS) Act into law. Also known as “the crowdfunding bill,” the JOBS Act aims to lessen regulation burdens on small businesses and has legalized equity crowdfunding. This includes removing the ban on general solicitation that prevents entrepreneurs from publicizing that they’re raising money. Previously, in U.S. there was a ban on ‘general solicitation’ or ‘general advertising’ of investment in securities, other than a prospectus-based offer. Title II of the JOBS Act deals with equity offers to accredited investors. Pursuant to SEC Rules under that Title, in effect from September 2013, US entrepreneurs may publicly advertise and market their company’s investment opportunity, of whatever size, to ‘accredited investors’ (in effect, individuals with over \$1 million in liquid net worth or annual incomes over \$200,000), including through the Internet or social media, as well as through print, radio or television.

Title III of the JOBS Act deals with Crowd Sourced equity Funding (CSEF) offers to investors generally. It is intended to allow start-up and other companies to use online intermediaries to obtain modest amounts of capital. Title III of the Act, the crowdfunding provision, has not yet come into force. Securities and Exchange Commission (SEC) issued the proposed rules on crowd-funding on the 23rd October 2013. New rules may allow non-accredited investors to also invest in equity. The rules have yet to be set in regards to the requirements on the platform or the start-up business; however it should include filling information, with SEC, on the issuer.

New Zealand

The recently enacted Financial Markets Conduct Act, 2013 (the Act) contains provisions designed to facilitate CSEF.

The new regulations in New Zealand enables companies to raise up to a maximum of \$2 Million from 20 investors in a year through crowdfunding without having to issue a prospectus. It covers both the varieties of crowdfunding: Equity Crowdfunding and Peer-to-Peer Lending. The market regulator, Financial Markets Authority, has asked both, equity crowd-funding platforms and peer-to-peer lenders, to apply for a license to operate.

Australia

The Corporations and Market Advisory Committee (Australian Government) recently came out with a Concept Paper on Crowdfunding and is currently in the process of framing rules for equity



based crowdfunding. The current regulations allow a startup to raise not more than \$ 20 Million or transfer equity to more than 20 people in any given 12 months. This system restricts this channel to a set of sophisticated investors. These rules are under revision.

Japan

Financial Services Agency (FSA), Japan has promulgated an amendment in Financial Instruments and Exchange Act on May 23, 2014 to facilitate and promote, inter alia, Equity Crowdfunding in Japan.

The amendments pertinent to Crowdfunding are given as under:

- Relaxation of Entry Requirements
 - I. Restrictions on the conduct of other businesses would not be imposed on crowdfunding platform operators that handle only 'small amounts' and the minimum capital required for registration would be reduced.
 - II. 'small amounts' mean that the total amount offered is less than 100 million yen and the amount of investment per person is 500,00 yen or less.
- Establishment of Rules to protect Investors
 - I. To prevent fraudulent behavior, crowdfunding platform operators would be obligated to conduct checks on the businesses of the start-ups and to provide information of issuers, etc. appropriately through the Internet.

Various jurisdictions have imposed different restrictions on investments and categories of investors who are allowed to invest in companies which are displayed on such internet based websites or platforms such as:

<i>Jurisdiction</i>	<i>Limitations on Investment under Crowdfunding</i>
USA	In a 12 month period, investors are allowed to invest <ul style="list-style-type: none">• \$2,000 or 5 percent of their annual income or net worth, whichever is greater, if both their annual income and net worth are less than \$100,000.• 10 percent of their annual income or net worth, whichever is greater, if either their annual income or net worth is equal to or more than \$100,000.
UK	<ul style="list-style-type: none">• No limit for investors advised by professionals, linked to corporate finance or venture capital firms, or those certified as sophisticated or high net worth.• Not more than 10% of assets - excluding homes and pensions, for other investors.
Australia	One of the option proposed is that the investor needs to be sophisticated i.e. have assets of worth at least \$ 2.5 million or have a gross income of at least \$ 250,000 for each of the last 2 financial years.
France	<ul style="list-style-type: none">• 1,000 per campaign
Canada	A maximum of \$2,500 in a single investment and \$10,000 per year

In Indian scenario, considering the necessity to provide alternative funding sources to Start-ups and at the same time to ensure that retail investors are not made to bear the risks of Start-up ventures, it is proposed to permit only Accredited Investors to participate in crowdfunding.



Recognition of Crowdfunding Platform in India

The Securities and Exchange Board of India's on June 17, 2014 has issued a consultation paper on proposed rules on crowdfunding aimed at allowing start-ups in India to raise funds from the general public over the Internet. The proposed rules would allow companies to raise as much as 100 million rupees (\$1.68 million) in a year through crowdfunding platforms while limiting the maximum number of individual investors in an issue to 200. The rules would also make it mandatory for institutional investors to buy at least 5 percent of a crowdfunded issue, while limiting maximum investment by an individual to 60,000 rupees per issue. Companies funded through such ventures would be required to make periodic disclosures to its investors, though the disclosure requirements would be much less stringent than those for publicly listed companies. Draft regulations envisage all such transactions through a demat account, currently used primarily to hold share certificates in electronic form. There are currently about 21.9 million such accounts in the country. India's first crowdfunding portal, **Pik A Venture** has been launched by an MBA student Ms. Ruchi Dana at Stanford Graduate School of Business in 2013 . In India, these platforms seem to prefer the creative arts such as films and social causes for raising capital from the general public. More recently, crowdfunding is becoming an increasingly common form of raising funds in the technology and media industries; including music, film and video games. Traditionally, crowdfunding is used to raise money to fund the development of a well-defined, singular project. The new form of crowdsourced private financing has lowered the barriers to entry not only for financing projects, but also for the average citizen to play the role of investor. Crowdfunding also has a unique dual function of providing both private financing and generating publicity and attention for a project.

End note

Regulators globally have begun devising rules to oversee the nascent platform, which has exploded in popularity as an alternative way for entrepreneurs to raise capital. The U.S. Securities and Exchange Commission (SEC) issued draft rules for crowdfunding during October, 2013, and similar rules by Canadian regulators were issued earlier this year. In line with the global regulators, SEBI has also come out with the consultation paper on Crowdfunding. The proposed structure for crowdfunding will provide an enabling framework. Crowdfunding may provide an alternative source of capital for entrepreneurs that either have limited access to capital or have exhausted other available sources of capital. This also saves the entrepreneur from a lot of effort required in obtaining capital and allows him/her to focus on the business. It helps to reduce the costs involved in raising funds for entrepreneurs.

There is a large opportunity in crowdfunding as it resolves the problem of lack of funding.

Crowdfunding not only helps the issuers to raise money but also serves as a way of advertising for these companies. It helps in increasing their visibility which can directly or indirectly lead to the growth in their businesses. Crowdfunding is expected to spur entrepreneurship and benefit the entire economy.

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“TIMES, THEY ARE CHANGING”

REGULATORY CHANGES IN CAPITAL MARKET

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Capital market is one of the crucial segments of the Indian financial system. It refers to all the facilities and the institutional arrangements for borrowing and lending of funds and is available to the companies for meeting their capital requirements. Capital is an essential element for the growth and development of a business. The demand for long term capital comes predominantly from private sector manufacturing industries, agriculture sector, trade and the Government agencies. While, the supply of funds for the capital market comes largely from individual and corporate savings, banks, insurance companies, specialized financing agencies and the surplus of Governments.

In a dynamic and competitive business environment, it is crucial for business to raise the requisite capital, in an efficient manner, at the right time and at an appropriate price. Therefore, there is a need to use a wide array of capital instruments judiciously in the backdrop of streamlined statutory and regulatory framework. This will render flexibility to the capital structure, assist in managing capital dynamically and enable reallocation of capital between businesses. In order to facilitate easy access to capital and its effective management, robust regulatory framework is inevitable as it serves twin objective of assisting issuers in meeting their capital requirements and monitoring the functioning of capital market.

The Securities and Exchange Board of India regulates the capital market in India. It is the regulatory authority established under the SEBI Act 1992, to protect the interests of the investors in securities and promote the development of the capital market in India. It has distinct responsibilities like, regulating the business in stock exchanges; supervising the working of stock brokers, share transfer agents, merchant bankers, underwriters, etc; as well as prohibiting unfair trade practices in the securities market. Over the last 20 years, SEBI has undertaken several steps to streamline and strengthen regulations relating to capital market which has led to various financial and regulatory reforms in both primary as well as secondary segments of the capital market. These measures broadly aim at ensuring that the law remains relevant at all times in the changing economic environment and **putting in place suitable mechanism to guard and sustain the confidence of investors in the country's capital market.** Some of the policy initiatives of SEBI that have been undertaken in the recent times which inter-alia includes:

1. SEBI (Foreign Portfolio Investors) Regulations, 2014

These regulations aims to put in place a framework for registration and procedures with regard to foreign investors who propose to make portfolio investment in India and thereby streamline the investments made by FIIs and QFIs in India. With the introduction of this regulation, SEBI (FIIs) Regulations, 1995 stand repealed. Key Features of these regulations are discussed below:

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Registration

SEBI has harmonized foreign institutional investors, sub-accounts and qualified foreign investors regimes into a single investor class i.e. Foreign Portfolio Investors, where an applicant shall seek registration as a foreign portfolio investor in one of the following three categories:

- o Category I- Government and Government related investors such as central banks, Governmental agencies, sovereign wealth funds and international or multilateral organizations or agencies;
- o Category II- (i) appropriately regulated broad based funds such as mutual funds, investment trusts, insurance/reinsurance companies; (ii) persons such as banks, asset management companies, investment managers/ advisors, portfolio managers; (iii) broad based funds that are not appropriately regulated but whose investment manager is appropriately regulated, subject to certain conditions; (iv) university funds and pension funds; and (v) university related endowments already registered with the Board as foreign institutional investors or sub-accounts.
- o Category III- All others not eligible under Category I and II foreign portfolio investors

A single window clearance has been introduced whereby each foreign investor can apply to register directly as a FPI (under the respective three categories) through Designated Depository Participants (DDPs). Further, DDPs will be responsible for carrying out KYC and other necessary due diligence of the applicant. The regulation also prescribes for the appointment of a compliance officer who shall be responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines and instructions issued by the DDPs or the Board or the Central Government.

Further, SEBI has also carved a framework of Risk Management for Foreign Portfolio Investors (FPIs) and the meaning of 'broad based fund' has been modified in the FPI Regulations as compared to the FII Regulations. FPI Regulations prescribes that a broad based fund will at all times require having 20 investors even if there is an institutional investor; and the underlying investors should be counted along with the direct investors while computing the number of investors in a fund.

Investment Restrictions

The regulation has laid down limit of 10% of the total issued capital of the company for purchase of equity shares of each company by a single FPI or an investor group. Investment by FPIs in unlisted equity shares is not permitted. Moreover, only category I and category II FPIs, except for unregulated broad based funds can issue, subscribe to or otherwise deal in offshore derivative instruments (ODIs), directly or indirectly subject to the certain conditions.

2. SEBI (Procedure For Search And Seizure) Regulations, 2014

SEBI notified new norms in January, 2014 empowering its Chairman to order search and seizure operations during investigations. It aims to put in place necessary safeguards to protect rights of affected persons and provide detailed procedures to be followed for issuance of warrants and execution of search and seizure orders. The new powers are aimed at making SEBI more effective in protection of investor interest and regulation of the market.



Under these regulations an investigating authority, having reason to believe that any or all of the grounds specified under section 11C (8) of the SEBI Act, 1992 exist, may make a request to the Chairman in writing or electronic mode for issuance of warrant of authority for execution of search and seizure. Further, certain rights of the persons being searched including the right to see the Warrant, and obtain a copy from the authorised officer, verify the identity of the authorised officer, and the officials assisting him are prescribed in these regulations. Any person / intermediary, who do not comply with the provisions of the regulations, will be liable for penalties including fines, imprisonment and cancellation of licenses under the SEBI Act and regulations thereunder.

3. SEBI (Real Estate Investment Trusts) Regulations, 2014

REIT is considered to be one of the preferred investment vehicles around the world, considering the important role played by it, SEBI has recently approved REIT regulations which provide a framework for registration and regulation of Real Estate Investment Trusts. Some of the important features of these regulations are:

Structure and Registration of REIT

REIT shall be set up as a trust and registered with SEBI and the parties to REIT shall be Trustee, Sponsors and manager where trustee shall have overseeing role, manager shall have operational responsibilities and the sponsor's responsibilities shall primarily pertain to setting up of the REIT including appointment of the Trustee.

Funding and Investment Restrictions

REIT shall invest in commercial real estate assets, either directly or through Special Purpose Vehicles (SPVs) and shall raise funds initially through an initial public offer with the minimum issue size of Rs 250 crore. Its units shall be mandatorily registered in the Recognized stock Exchange and continuous disclosures shall be made in terms of the listing agreement. The regulations lays down that borrowings and deferred payments at consolidated level shall not exceed 49% of the value of its assets and at least 80% of the value of its assets shall be in the completed and revenue generating assets. Further, regulations also prescribes that REIT shall undertake full valuation through a registered valuer on a yearly basis.

4. SEBI (Infrastructure Investment Trusts) Regulations, 2014

To provide a framework for registration and regulation of infrastructure Investment Trust SEBI has approved SEBI (Infrastructure Investment Trusts) Regulations, 2014. Key features of these regulations are given below:

Structure and Registration

Like REITs, Infrastructure Investment Trusts (InvIT) shall also be set up as a trust and registered with SEBI. Parties to it shall be Trustee, Sponsors, Investment Manager and Project Manager.

Funding and Investment Restrictions

InvITs shall invest in infrastructure projects, either directly or through SPV. In case of PPP projects, such investments shall only be through SPV. The regulations propose that an InvIT may invest only upto 20% in under construction infrastructure projects and other permissible investments.



An InvIT shall hold or propose to hold controlling interest and more than 50% of the equity share capital or interest in underlying SPV. However, its aggregate consolidated borrowing and the underlying SPVs shall never exceed 49% of the value of its assets. The holding of an InvIT in the underlying assets shall not be less than 500 crore and the initial offer size shall not be less than Rs 250 crore.

Apart from the above new regulations, SEBI has also amended the existing regulations to further strengthen the regulations and ensure that the law remains relevant at all times in the rapidly changing economic landscape. Some of these are discussed below:

1. Amendment in KYC (Know Your Client) Registration Agency Regulations, 2011

In order to provide for the Sharing of KYC information in the financial sector the following regulation 16A has been inserted which states that:

- (1) The entities, regulated by other regulators in the financial sector specified by the Board from time to time, may access the system of KRA for undertaking KYC of their clients who engage them for financial services.
- (2) The provisions of these regulations shall, mutatis mutandis, apply to the entities regulated by other regulators specified in sub-regulation (1).

Further, in regulation 16 for clause (b) following has been substituted as:

"(b) When the client approaches another intermediary subsequently, the intermediary shall verify and download the **client's details from the system of KRA**

Provided that upon receipt of information on change in KYC details and status of the clients by the intermediary or when it comes to the knowledge of the intermediary, at any stage, the intermediary shall be responsible for uploading the updated information on the system of KRA and retaining the physical documents."

2. Establishment of Connectivity with both depositories NSDL and CDSL – Companies eligible for shifting from Trade for Trade Settlement (TFTS) to Normal Rolling Settlement

The stock exchanges may consider shifting the trading in these securities to normal Rolling Settlement subject to the condition that at least 50% of other than promoter holdings as per clause 35 of Listing Agreement are in dematerialized mode before shifting the trading in the securities of the company from TFTS to normal Rolling Settlement.

For this purpose, the listed companies shall obtain a certificate from its Registrar and Transfer Agent (RTA) and submit the same to the stock exchange/s. However, if an issuer-company does not have a separate RTA, it may obtain a certificate in this regard from a practicing company Secretary/Chartered Accountant and submit the same to the stock exchange/s.

3. Listing Agreement

The Companies Act, 2013 was enacted on August 30, 2013 which provided for a major overhaul in the Corporate Governance norms for all companies requiring major steps be undertaken by SEBI to enhance the synchronisation between the corporate laws and securities laws. The convergence move has started by incorporating components of some sections of new Companies Act, 2013 in the form of clauses and sub-sections in the Securities Law. In order to



align the provisions of the Listing Agreement in this regard with the provisions of the Companies Act, 2013 and adopt best practices on corporate governance.

SEBI came out with Corporate Governance in listed entities - Amendments to Clauses 35B and 49 of the Equity Listing Agreement which lays down the detailed corporate governance norms for listed companies providing for stricter disclosures and protection of investor rights, including equitable treatment for minority and foreign shareholders. The new norms are aligned with the Companies Act, 2013 and are aimed to encourage companies to adopt best practices on corporate governance. The highlights of the revised Clause 35B and 49 are as follows:

(1) *Clause 35B*

Listed companies are required to provide the option of facility of e-voting to shareholders on all the resolutions proposed to be passed at general meetings or through postal ballot.

(2) *Clause 49*

- Exclusion of nominee Director from the definition of Independent Director.
- At least one woman director on the Board of the company.
- Compulsory whistle blower mechanism.
- Expanded role of Audit Committee.
- Prohibition of stock options to Independent Directors.
- Separate meeting of Independent Directors.
- Constitution of Stakeholders Relationship Committee.
- Enhanced disclosure of remuneration policies.
- Performance evaluation of Independent Directors and the Board of Directors.
- Prior approval of Audit Committee for all material Related Party Transactions (RPTs)
- Approval of all material RPTs by shareholders through special resolution with related parties abstaining from voting.
- Mandatory constitution of Nomination and Remuneration Committee. Chairman of the said committees shall be independent.
- The maximum number of Boards an independent director can serve on listed companies be restricted to 7 and 3 in case the person is serving as a whole time director in a listed company.
- To restrict the total tenure of an Independent Director to 2 terms of 5 years. However, if a person who has already served as an Independent Director for 5 years or more in a listed company as on the date on which the amendment to Listing Agreement becomes effective, he shall be eligible for appointment for one more term of 5 years only.
- The scope of the definition of RPT has been widened to include elements of Companies Act and Accounting Standards.



4. Public Issue of Debt Securities

Companies Act, 2013 and the Rules made there under do not specify the quantum of minimum subscription needed in case of public issues (both for equity and debt), but only requires disclosure of the same in the offer document.

Minimum Subscription Limit

In view of this, it has been decided that the minimum subscription for public issue of debt securities shall be specified as 75% of the base issue size for both NBFCs and Non NBFC issuers. Further, if the issuer does not receive minimum subscription of its base issue size (75%), then the entire application monies shall be refunded within 12 days from the date of the closure of the issue. In the event, there is a delay, by the issuer in making the aforesaid refund, then the issuer shall refund the subscription amount along with interest at the rate of 15% per annum for the delayed period. However, the issuers issuing tax-free bonds, as specified by CBDT, shall be exempted from the above proposed minimum subscription limit.

Base Issue Size

In any public issue of debt securities, it has been decided that the Base Issue size shall be minimum Rs. 100 crores.

Retention of Over-Subscription Limit

Currently, in respect of public issue of Non Convertible Debentures (NCDs), SEBI Issue and Listing of Debt Securities (ILDS) Regulations does not specify any maximum cap on the retention of over subscription. In general, issuers shall be allowed to retain the over-subscription money up to the maximum of 100% of the Base Issue size or any lower limit as specified in the offer document.

However, for the issuers filing a shelf prospectus, they can retain oversubscription up to the rated size, as specified in their Shelf Prospectus. The issuers of tax free bonds, who have not filed Shelf Prospectus, the limit for retaining the oversubscription shall be the amount, which they are authorised by CBDT to raise in a year or any lower limit, subject to the same being specified in the offer document.

Further Disclosures in the Prospectus

As per Schedule I of SEBI ILDS Regulations, companies making public issue of NCDs need to specify the "Object of the issue" in the offer document. SEBI has come out with stringent disclosure requirements which requires the entities coming out with public issue of NCDs to provide granular disclosures in their offer document, with regards to the "Object of the Issue" including the percentage of the issue proceeds earmarked for each of the "object of the issue". Further, the amount earmarked for "General Corporate Purposes", shall not exceed 25% of the amount raised by the issuer in the proposed issue. Further the NBFCs shall have to disclose in their offer document, the details with regards to the lending done by them, out of the issue proceeds of previous public issues, including details regarding the Lending policy, Classification of loans/advances etc.

Disclosures in the offer document for public issue of NCDs

In order to facilitate investors to take an informed decision for making investment in the proposed issue SEBI has decided to follow additional disclosure in the Offer Document by the issuer. The Offer



Document shall contain a disclaimer clause in bold letters stating that submission of Offer Document to SEBI should not be deemed to have been cleared or approved by SEBI. Further the lead merchant banker is expected to exercise due diligence to ensure that the issuer discharges its responsibility and furnish to SEBI a due diligence certificate in this regard.

Conclusion

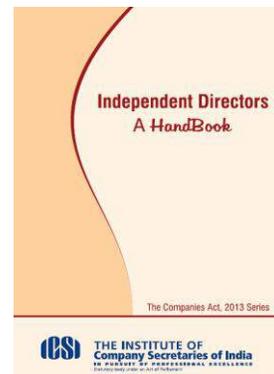
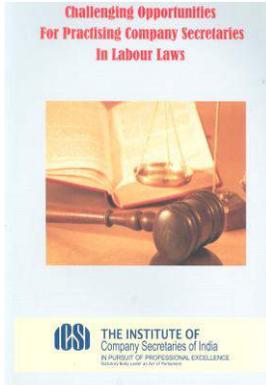
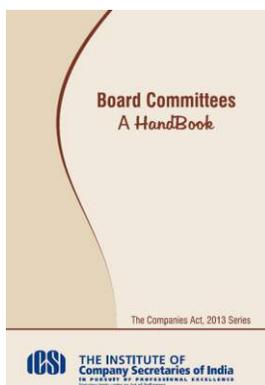
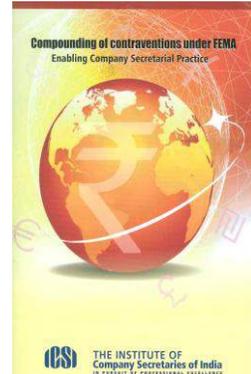
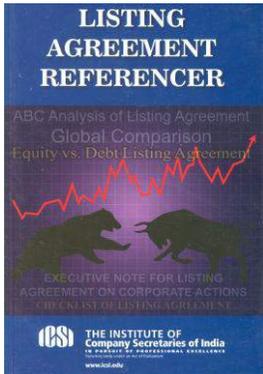
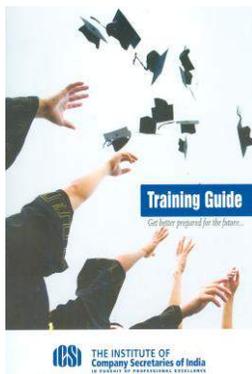
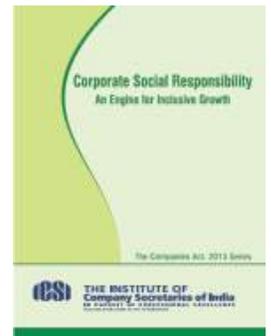
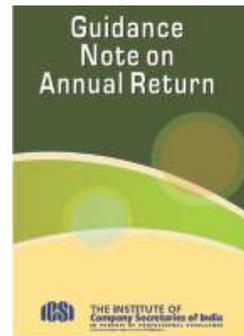
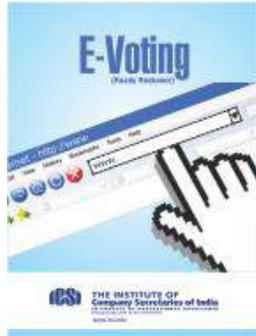
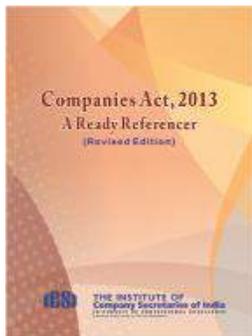
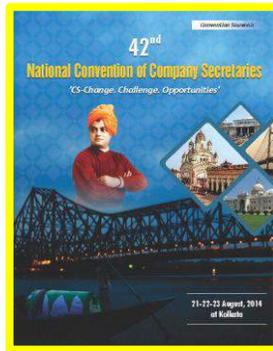
It has been observed that evolving regulatory climate is part and parcel of every economy, particularly of developing economy like India where new sectors are opening up continuously. As India seeks sustained GDP growth, the role of the capital markets to mobilize investments has become more critical. Considering the size, vintage and development of the Indian capital market, regulators need to ensure that the law remains relevant at all times and the business is conducted in an ethical and transparent manner.

The recent regulatory changes in the capital markets have a considerable impact on how businesses are conducted in India. The corporate sector needs to adapt to these changes and build their ability in order to showcase their role as value-creators. Further, it is felt that international best practices should be continuously adapted to the Indian situation to provide an enabling framework that ensures credibility of corporate operations in the minds of the stakeholders.

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42nd National Convention of Company Secretaries Closing Plenary

Sitting on the Dais from L to R : Shri Sutanu Sinha, Chief Executive, ICSI; Shri Anil Murarka, Past President and Council Member and Chairman, Convention Organising Sub-committee, ICSI; Shri H M Bangur, Managing Director, Shree Cement Ltd.; Shri Vikas Y Khare, Vice-President, ICSI; Hon'ble Justice Nadira Patherya, Calcutta High Court; Swami Suparnananda, Ramkrishna Mission Institute of Culture; Dr. Udit Raj, Hon'ble Member of Parliament; Shri R Sridharan, President, ICSI; Shri Ashok Pareek, Council Member, ICSI; Shri Arun Kumar Khandelia, Chairman, EIRC of ICSI.

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