

# An Analysis of OECD Principles of Corporate Governance *vis-à-vis* Indian Corporate Laws



**Gaurav Pingle, ACS**

Assistant Editor, LawStreetIndia  
Pune

[acsgauravpingle@gmail.com](mailto:acsgauravpingle@gmail.com)



**Deepti Dole, ACS**

Company Secretary & Legal Counsel  
Sungard Availability Services (India)  
Private Limited  
Pune

[doledeepti@gmail.com](mailto:doledeepti@gmail.com)

## INTRODUCTION

The purpose of Corporate Governance ('CG') is to help in building an environment of trust, transparency and accountability necessary for fostering long-term investment, financial stability and business integrity, thereby supporting stronger growth and more inclusive societies. The OECD Principles of Corporate Governance ('Principles') provide such benchmark. The principles identify the key in building blocks for sound corporate governance framework and offer practical guidance for implementation at a national level. The Principles direct the policy

## GOVERNANCE

The Draft principles were discussed by OECD Corporate Governance Forum in April 2015 and following the meeting, OECD Council adopted the Principles on July 8, 2015. The Principles were then submitted to G-20 Leaders Summit on 15-16 November 2015, where they were endorsed. In order to ensure their continuing relevance and accuracy, their review was supported and informed by extensive empirical and analytical work addressing relevant changes in both the corporate and financial sectors, for which the OECD Secretariat and

India is largely compliant with the revised OECD Corporate Governance Principles which seek to identify the key in building blocks for sound corporate governance framework and offer practical guidance for implementation at a national level. If India proposes to overhaul its existing CG framework based on the revised OECD CG Principles, it may not be a herculean exercise for the Indian companies in its implementation.

makers to evaluate and improve the legal, regulatory, and institutional framework for corporate governance, with a view to supporting economic efficiency, sustainable growth and financial stability. This article is a compilation and analysis of the OECD Principles of Corporate Governance with the Indian corporate law – Companies Act, 2013/1956 and the SEBI (Listing Obligations and Disclosure requirements) Regulations, 2015 ('SEBI LODR'). There is comparative analysis of Indian corporate laws with each OECD Principle citing commonalities and differences in the same.

Corporate Governance Committee reached out to a large number of experts, organisations and research institutions. The next step for OECD working with G-20 and stakeholders is to promote and monitor effective implementation of the revised Principles, which will include comprehensive review of Methodology for assessing its implementation.

## VIEWS OF SEBI'S INTERNATIONAL ADVISORY BOARD

In the 6th meeting of International Advisory Board ('IAB') of SEBI held on December 21 & 22, 2015, the IAB commended impressive degree of India's compliance

## BACKGROUND OF OECD PRINCIPLES OF CORPORATE

<sup>1</sup> SEBI Press Release No. 297 / 2015 dated December 23, 2015

with new OECD Principles. It was noted that India is by and large compliant with the revised principles and it might not be necessary to immediately try to be compliant on one or two remaining areas. The IAB also observed that while new OECD code recognizes variation in equity markets in different jurisdictions, an advanced code however may not be a guarantee for a well-functioning corporate sector.

The IAB also noted that there is too much focus on external governance whereas internal governance of corporations is equally important. Also, different corporations may have to be treated differently in terms of CG norms considering the complexity and their ownership structure. The Board agreed that effective enforcement of prescribed standards is also important and was suggested that SEBI may have a strategy to implement its existing policies on the ground.

## PRINCIPLE I: ENSURING THE BASIS FOR AN EFFECTIVE CORPORATE GOVERNANCE FRAMEWORK

The first OECD principle of CG suggests that policy makers have a responsibility of putting in place a framework that is flexible enough to meet the needs of corporations operating in widely different circumstances, facilitating their development of new opportunities creating value and determining the most efficient deployment of resources. The other factors that may call for flexibility include company's ownership and control structure, geographical presence, sectors of activity, and company's stage of development.

## CONSULTATION PROCESS IN INTRODUCING/AMENDING LEGISLATION

OECD also suggests that if new laws and regulations are needed, for dealing with clear cases of market imperfections, they should be designed in a way that makes them possible to implement and enforce in an efficient and even handed manner covering all parties. The effective way includes Govt. consultation with corporations, their representative organisations and other stakeholders. It states that mechanisms should also be established for parties to protect their rights. With the objective of avoiding over-regulation, unenforceable laws, and unintended consequences that may impede business dynamics, the policy measures should be designed with a view to their overall costs and benefits.

Considering the Indian context, the relevant and the most recent example is the introduction and contents of the Companies (Amendment) Bill, 2016 ('the Bill') which is based on the Companies Law Committee Report. After issue of the Report, which contained approximately 100+ proposed amendments, the same was made open for public comments. The Government based on the entire exercise of receiving public comments on the proposed amendments to Companies

Act, 2013 ('the Act'), drafted the Bill which was presented in Lok Sabha on March 16, 2016. The Amendment Bill aims to bring in the much needed ease of doing and ironing the complexities and absurdities in the Act. Another example of the consultative process is the introduction of Regulations by SEBI. SEBI floats consultative or discussion papers and seeks public comments by giving a reasonable time frame. Based on the industry feedback and SEBI's consultative process with other government departments, SEBI then introduces Regulations.

## VARIETY OF LEGAL INFLUENCES CAUSES UNINTENTIONAL OVERLAPS

OECD has acknowledged the key issue, wherein CG requirements and practices are influenced by an array of legal domains which includes company law, securities regulation, accounting standards, auditing standards, insolvency law, contract law, labour law and tax law. Sub-principle states that there is a risk that variety of legal influences may cause unintentional overlaps and even conflicts, which may frustrate the ability to pursue key CG objectives. With an objective of eliminating such risk, it states that policy-makers are aware of the risk and take measures to limit it. The Related Party transactions ('RPT') is a classic example in this context wherein multiple regulations like the Act, SEBI LODR, Accounting standards, Transfer pricing guidelines define and regulate RPT in a different manner creating conflicts thereby frustrating the ability to pursue CG.

It further proposes that effective enforcement requires that the allocation of responsibilities for supervision, implementation and enforcement among different authorities is clearly defined so that competencies of complementary bodies and agencies are respected and used most effectively. It states that overlapping and contradictory regulations between jurisdictions is also an issue that should be monitored so that no regulatory vacuum is allowed to develop and to minimize the cost of compliance with multiple systems by corporations. Recent judgment in Sahara case has cleared the fog about the jurisdiction of SEBI with respect to public issue and the same has now been incorporated clearly in the Act. Also the Bill now aims to omit Section 195 of the Act



‘ In jurisdictions where enforcement of legal and regulatory framework is weak, OECD suggests that *ex ante* rights of shareholders be strengthened, which includes low share ownership thresholds for placing items on the agenda of shareholders meeting or by requiring supermajority of shareholders for certain important decisions. This principle supports equal treatment for foreign and domestic shareholders in CG. ’

with respect to the Insider Trading to avoid multiple legislation as the SEBI (Prohibition of Insider Trading) Regulations, 2015 are already in place.

## PRINCIPLE II: RIGHTS AND EQUITABLE TREATMENT OF SHAREHOLDERS AND KEY OWNERSHIP FUNCTIONS

The second OECD principle provides a mechanism for protecting and facilitating exercise of shareholders' rights and ensuring equitable treatment to all shareholders. It states that all shareholders should have opportunity to obtain effective redress for violation of their rights.

### Appropriate demarcation of shareholders' & director's authority

It states that the corporation cannot be managed by 'shareholders' referendum', wherein the shareholding body is made up of individuals and institutions whose interests, goals, investment horizons and capabilities vary and the corporation's management must be able to take business decisions rapidly. Taking note of such realities and complexity of managing corporation's affairs in fast moving markets, OECD suggest that shareholders are not expected to assume the responsibility for managing corporate activities. It states that responsibility of corporate strategy and operations is placed in hands of board of directors. Under the Act, there is demarcation of roles, responsibilities and approval process among the shareholders and board of directors. Section 179 of the Act states about the Powers of the Board and Section 179(3) lists the powers to be exercised only at the meetings of Board. Whereas, Section 180 relates to 'restrictions on the powers of the Board', which prescribes a list of powers which can be exercised only with the consent of the company by special resolution.

### Significance of Investor Confidence

OECD observes that an important factor in development and proper functioning of capital markets is 'investors' confidence', which means that investors are protected from misuse or misappropriation by corporate managers, board or controlling shareholders. It states that in providing protection to investors, distinction can be made between 'ex ante rights' (pre-emptive rights

and qualified majorities for certain decisions) and 'ex post rights' (allow seeking of redressal, once rights have been violated). In jurisdictions where enforcement of legal and regulatory framework is weak, OECD suggests that *ex ante* rights of shareholders be strengthened, which includes low share ownership thresholds for placing items on the agenda of shareholders meeting or by requiring supermajority of shareholders for certain important decisions. This principle supports equal treatment for foreign and domestic shareholders in CG.

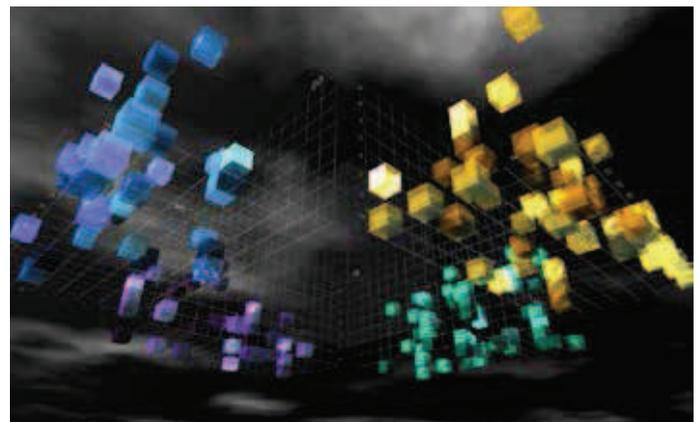
### Challenging Corporate Action Vs Excessive Litigation

OECD notes that there are some risks in the legal system which enables the investor to challenge corporate activity in the courts which amounts to excessive litigation. It states that many legal systems have introduced provisions to protect management and board members against litigation abuse in the form of tests for sufficiency of shareholder complaints, i.e. 'safe harbours for management and board member actions', which means 'best judgment rule'. Hence, it is necessary to strike a balance between allowing investors to seek remedies for infringement of ownership rights and avoiding excessive litigation. It states that many countries have found that alternative adjudication procedures, such as administrative hearings or arbitration procedures organised by securities regulators. Hence specialised court procedures can also be practical instrument for obtaining timely injunctions, and facilitate rapid dispute settlements.

In the Indian context, Section 397/398 of Companies Act, 1956 provided for a mechanism for filing of oppression and mismanagement petitions against company management by shareholders having requisite shareholding, thereby avoiding frivolous and trivial complaint by the shareholders. Section 245 of the Companies Act, 2013 relates to 'class action', which provides member(s) or depositor(s) to file class action suit, if they are of the opinion that management or conduct of company affairs are being conducted in manner prejudicial to company's interests or its members or depositors. With respect to the alternative adjudication procedures, there are also adequate provisions under SEBI Regulations and Stock Exchange rules for alternative remedies for dispute between trading members and investors, which facilitates rapid dispute settlements.

### Importance of shareholder's meeting

OECD highlights that the right to participate in shareholders'



The idea of ‘paying attention to key stakeholder relationships’ is and has been of utmost importance in the strategic management. The vital aspect of CG lies in ensuring that there is flow of external capital to companies, whether owned or borrowed/debt capital. However, the existence, growth and success of the companies are a contribution by various stakeholders including employee, shareholders, creditors, suppliers, customers and other stakeholders and hence their interests be protected.

meeting is a fundamental shareholder right and the management/controlling investors have sometimes discouraged non-controlling/foreign investors from trying to influence company’s direction.

### Managerial Remuneration & Disclosures

In the sub-principle, OECD observes the shareholders should be able to make their views known on directors’ remuneration of board members and/or key executives. The equity component of compensation schemes for board members and employees should be subject to shareholder approval. The Act in line with the OECD principles ensure that there is adequate shareholders’ participation (voting by attending the meeting, proxy, electronic voting, remote electronic voting (which has been a maiden attempt to improve shareholders participation) and postal ballot and the companies are required give necessary disclosures under the Act and SEBI LODR. With respect to Directors’ remuneration under the Act, the quantum of disclosures differs from whether the company is earning profit, inadequate profit or suffering losses.

### Inter-se consultation of shareholders

OECD proposes that shareholders, including institutional shareholders, should be allowed to consult with each other on



issues concerning their basic rights, subject to exceptions to prevent abuse. In relation to this, OECD observes that co-operation among investors could also be used to manipulate markets and to obtain control over company without being subject to any Takeover Regulations or Disclosure Regulations. However, it cautions that co-operation might also be for the purposes of circumventing competition law. Hence, with an objective of providing more clarity, OECD suggests that the regulators may issue guidance on form of co-ordination and agreements that do or do not constitute such acting in concert in Takeover and other rules.

## PRINCIPLE III: INSTITUTIONAL INVESTORS, STOCK MARKETS, AND OTHER INTERMEDIARIES

The third OECD principle of CG states that the framework should provide sound incentives throughout investment chain and provide for stock markets to function in a way that contributes to good CG.

The sub-principles recommend that institutional investors disclose their policies w.r.t. CG. In case of institutions acting in a fiduciary capacity (e.g. pension funds, collective investment schemes and some activities of insurance companies, and asset managers acting on their behalf), OECD observes that the right to vote can be considered part of the value of investment. Failure to exercise ownership rights could result in loss to investor who should be made aware of the policy to be followed by Institutional Investors.

In the Indian context, companies are under legal obligation to provide electronic voting facility, remote electronic voting facility, in addition to the postal ballot and voting at the meeting (by poll or by show of hand). Institutional Investors are also involved in the dialogue with the board and management relating to the strategic and management discussions affecting the company’s operations at large.

## REGISTRATION OF ADVISORS & THEIR ROLE

The sub-principles further suggests that CG framework should require that proxy advisors, analysts, brokers, rating agencies (collectively abbreviated as “Advisors”) that provide analysis or advice relevant to decisions by investors should disclose and minimize conflicts of interest that might compromise the integrity of their analysis/advice. OECD notes that proxy advisors who offer recommendations to institutional investors on how to vote and sell services that help in voting process are among the most relevant from direct CG’s perspective. Further it is observed that the Advisors in certain cases also offer CG related consulting services to corporations.

It further observes that many jurisdictions have adopted regulations or encouraged the implementation of self-regulatory codes designed to mitigate conflicts of interest or other risks related to integrity, and have provided for private and/or public monitoring arrangements. OECD suggests that the providers of proxy advisory services should disclose publicly and/or to investor clients the process and methodology that underpin their recommendations, and the criteria for their voting policies relevant for their clients.

In line with this, SEBI has introduced Research Analyst Regulations, 2014 which monitors and manages conflicts of interest and disclosure requirements, limits trading by research analysts and publication of research report, public appearance and conduct of business, disclosures in research reports and recommendations in public media. Pursuant to the Research Analyst Regulations, 2014, Proxy Adviser shall additionally disclose following information: (i) Extent of research involved in particular recommendation and the extent and/or effectiveness of its controls and procedures in ensuring accuracy of issuer data; (ii) Policies and procedures for interacting with issuers, informing issuers about recommendation and review of recommendations. SEBI also suggests that proxy adviser shall maintain record of the voting recommendations and furnish the same to it on request.

## PRINCIPLE IV: STAKEHOLDER'S ROLE IN CG

The fourth OECD principle highlights that the framework should recognize the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.

## IMPORTANCE OF VARIOUS STAKEHOLDERS IN CG

The idea of 'paying attention to key stakeholder relationships' is and has been of utmost importance in the strategic management. The vital aspect of CG lies in ensuring that there is flow of external capital to companies, whether owned or borrowed/ debt capital. However, the existence, growth and success of the companies are a contribution by various stakeholders including employee, shareholders, creditors, suppliers, customers and other stakeholders and hence their interests be protected.

The sub-principle specifically articulates that where stakeholder should have the opportunity to obtain effective redress for violation of their rights and where stakeholders participate in the CG process, they should have access to relevant, sufficient and reliable information on a timely and regular basis.

## EMPLOYEE'S PARTICIPATION

This sub-principle also emphasizes that mechanism be developed for employee participation in the CG framework. However, this may vary depending the size and operation scales of the company and the laws applicable. In the Indian context, it can be noted that 'Internal Complaints Committee' formed under Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, comprises of specified employees, providing the participation of employees. Further, various Employee Stock Option Schemes, thereby making the employees, the owners of company, increases their participation in the CG.

Another sub-principle states that the stakeholders, including individual employees and their representative bodies, should be able to freely communicate their concerns about illegal or unethical practices to the board and to the competent public authorities and their rights should not be compromised. Both the Act and SEBI LODR enunciate that the companies should establish vigil mechanism/whistle-blower Policy wherein the employees can

report any bona fide complaint to Audit Committee or Board without any fear of unfair treatment including fear of retaliation.

## EFFECTIVE & EFFICIENT INSOLVENCY FRAMEWORK

The last sub-principle states that the framework should be complemented by an effective, efficient insolvency framework and by effective enforcement of creditor rights. In Indian context the creditors can enforce their rights by filing a petition for winding-up the company in case the company is unable to pay its debts or a scheme of compromise and arrangement can also be reached between the creditors and company. As Insolvency and Bankruptcy Code has still not seen light of the day in India, the existing mechanism provided are not very effective or in line with the international practices.

## PRINCIPLE V: DISCLOSURES & TRANSPARENCY

The fifth OECD principle emphasizes that CG framework should ensure timely and accurate disclosure be made on all material matters regarding corporation, including financial situation, performance, ownership and governance. The sub-principles lay down various disclosures pertaining to material information, which highlights that such information should be in accordance with high standards of accounting, financial and non-financial reporting.

## WHY DISCLOSURES?

Disclosure of "material information" is regarded as foundation to transparency amongst the shareholders. The ambit of such dissemination of information may vary from private companies to listed companies. However, it is emphasized that "time" is an essence for such disclosures and it should be disseminated to all the shareholders for equitable treatment. Though the ideology is not to endanger company's competitive position, or increase compliance cost but "disclosures" aims to be a powerful tool for protecting the investors, attracting capital and maintaining high confidence amongst stakeholders about company's functioning. It has proved that weak, non-compliant or unethical practices weakens investor's confidence and have significant negative effect on company's cost of equity capital and market reputation. The disclosures can be of on-going in nature, periodic or "immediate" or "as soon as possible" disclosures of material development.

This OECD principle is in line with disclosures provided under the Act and SEBI LODR. These disclosures relates to financial



statements, Board's Report, Annual Report, management analysis, shareholding pattern & its changes, RPT, risk factors, appointment, resignation, remuneration of Directors & KMP, Code of Conduct, CSR Policy, policy to determine 'materiality', Whistle-blower Policy, policy on diversity of Board, continuing disclosures on the company's website, stock option schemes, price-sensitive information, etc.

Further to have a fair and independent representation of financial statements, it is been mandated that companies shall implement applicable Accounting Standards in letter and spirit in preparation of financial statements taking into consideration interest of all stakeholders and shall also ensure that annual audit is conducted by an independent, competent and qualified auditor. Further, the SEBI LODR mandates in line with OECD Principles that channels for disseminating information shall provide for equal, timely and cost efficient access to relevant information by investors.

## PRINCIPLE VI: RESPONSIBILITY OF THE BOARD OF DIRECTORS

The sixth OECD principle lays down that the CG framework should ensure strategic guidance of company, effective monitoring of management by Board, and Board's accountability to the company and shareholders.

In the evolution of the 'organic theory', in the well-known English judgment in *Lennard's Carrying Co Ltd v Asiatic Petroleum Co Ltd* [1915] AC 705 in which Viscount Haldane LC said: 'a corporation is an abstraction. It has no mind of its own any more than it has a body of its own; its active and directing will must consequently be sought in the person of somebody who for some purposes may be called as an agent, but who is really the directing mind and will of the corporation, the very ego and centre of the personality of corporation.' Thus, the organic theory of corporate life treats directors as directing mind and will of company or organs of the company for whose actions the company is held liable. Hence, the Board of directors is entrusted with chief responsibilities which include governing the enterprise, monitoring management, overseeing risk management, achieving an adequate return for shareholders, preventing conflict of interests and ensuring that company complies with applicable laws.

## DIRECTORS' DUTIES

The sub-principle highlights that for discharging functions effectively, and in order to fulfil their responsibilities, board members should have access to accurate, relevant and timely information. Basis the plethora of precedents, the Section 166 of the Act also in line with OECD Guidelines substantiates and casts duty on the board of directors to act in good faith, diligently and in company's best interest. This principle accentuates two prime elements of the fiduciary duty of the Board which are 'duty of care' and 'duty of loyalty'.

The Code of conduct as detailed in the SEBI LODR is in line with the sub-principle enshrined stating that board of directors should apply high ethical standards and take into account stakeholders' interest. The sub-principle highlights that Board should fulfil certain key functions which are mirrored in SEBI LODR.

## OPTIMUM COMPOSITION OF BOARD OF DIRECTORS

The sub-principles also emphasizes that the Board should have an optimum combination of non-executive & executive Board members to avoid potential conflict of interest like RPT. The Act and SEBI LODR in line with the OECD principles provides for formation, roles & responsibilities of Audit Committee, Nomination & Remuneration Committee, CSR Committee & Stakeholders Relationship Committee with prescribed mix of executive, non-executive and independent directors.

The Act also laid a maiden step that the Directors' Report should contain a statement indicating manner in which formal annual evaluation has been made by the Board of its own performance and that of its committees and individual directors. These steps enshrine the sub-principle that Boards' should regularly carry out evaluations to appraise their performance and assess whether they possess the right mix of background and competences.

## EMPLOYEES' REPRESENTATION ON BOARD

OECD sub-principle refers to "employee representation" on Board whether mandated by law or collective agreements, or voluntary adoption. It further substantiates that a mechanism be evolved to provide access to information and training for such employee representatives, so that this representation is exercised effectively and best contributes to the enhancement of board skills, information and independence. In Indian context, though we do not come across such "Employee representation" it can be looked into from the "Small Shareholders Directors" perspective and the principles referred may be applied.

## CONCLUSION

It can be said that the India is largely compliant with the revised OECD Corporate Governance Principles except few areas / sub-principles. Therefore, if India proposes to overhaul its existing CG framework based on the revised OECD CG Principles, it may not be a herculean exercise for the Indian companies in its implementation. It also noteworthy that SEBI's International Advisory Board<sup>2</sup> opined that 100% compliance with OECD principles, though desirable, may not be absolutely necessary. It is essential that every key stakeholder understands the principles and sub-principles along with the implication of OECD Corporate Governance Principles, which may have an impact on not only Indian companies but also its holding companies, subsidiary companies and associate companies incorporated outside India. The Principles are important and relevant in cross-listing or cross-border merger or acquisition, as well. 

## Reference

OECD (2015), G20/OECD Principles of Corporate Governance, OECD Publishing, Paris. <http://dx.doi.org/10.1787/9789264236882-en>

2 SEBI Press Release No. 297 / 2015 dated December 23, 2015