



A BRIEF STUDY ON LAW RELATING TO CORPORATE GOVERNANCE IN INDIA AND SIGNIFICANCE OF ETHICS IN CORPORATE GOVERNANCE

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ABSTRACT

In any corporate framework, corporate governance plays an important role in establishing strong and stabilised economic structure and contributes for the development of a company in an efficient and effective manner. Well structured corporate governance can enhance the profit of a company along with ethical standards of the company. The Companies Act 2013, has been enacted to emancipate corporate governance in an advanced manner by introducing novel features like corporate social responsibility, independent directors, women directors, etc in the Act. The major focus of the corporate governance is to maintain accountability, responsibility along with transparency and fairness. Ethical qualities and standards are always laid down in any discipline, profession and in company business as well. The companies along with their profit motive should also think off social responsibilities and ethical values because ethical deterioration can put business value at risk. The companies are also abiding by the rules and regulations and the laws governing their establishment and administration.

Keywords

Corporate Governance, Business Ethics, Corporate Social Responsibility, Companies Act.

Aims and Objectives

The main aims and objectives of the study are as follows:

- To know about the law connected to Corporate Governance
- To study on business ethics and its significance in Corporate Governance
- To know the relation between ethics and law in a corporate system

Material and Methods

The study is done through doctrinal method and the materials and tools used for the study is secondary sources like Statutes, textbooks, case analysis, judicial decisions, journals, magazines etc.

1. Introduction

The corporate governance is a mechanism to administer and govern a particular company or corporate entity with certain rules and principles.

Even though profit making is the main motive and aim of any enterprise, corporate governance guides them to be on right path of business with business ethics. There are shareholders, stakeholders including team of investors in every company and confidence of all the members should be there to run a company in a systematic and profitable manner. Business ethics and legal regulations should be maintained in the business of any company. Directors of company are neither the employees nor the owners of the company, they are taken up with the responsibility to run the company in a magnificent manner. To look after audit and accounts of the company, committees will be formulated and corporate governance provisions are incorporated in new Companies Act 2013. Ethics in business provides working direction, operation, and management of a corporate sector. Certain situations may arise in which companies or enterprises may violate environmental rules,



human values etc for the sake of business, but by considering them as moral and ethical responsibility not to violate such fundamental values.

2. Corporate Governance and its Significance

The corporate governance plays a significant role in the business of any company and corporate governance in India mainly focuses on various aspects like protecting minority shareholders, looking after the accountability of the Board of Directors, maintaining corporate social responsibility etc. Corporate governance includes certain implicit and explicit contracts that are entered into between the companies and it also narrates distribution of rights, rewards, and responsibilities of stakeholders. The significance and need of corporate governance have become more prominent because of non-compliance in financial matters, accountability, and management on the part of the directors and officials of the company.

Corporate governance plays an important role in a system of changing relationship structure. Stakeholders of any corporate entity are spread worldwide and to maintain a uniform system of administration, rules and regulations must be implemented accordingly. The company should develop a very good relationship with its stakeholders. Corporate governance also becomes significant in stimulating social responsibility on the part of a company. The companies may be of different disciplines like manufacturing units of textiles, cement production, spare part producers, steel industries, construction companies etc. and need not be necessarily any software company. The activities that are undertaken by such corporate giants or companies may have negative implications on environment, contribution to pollution, human rights violation etc. But such activities are not expected to occur in any company while conducting their business or during its functioning. Protection and preservation of environment, sustainable development, pollution free production system, upholding human values etc are most common things expected from a company by the law and society. To strike the balance between profitability and the ethics can

be made possible through corporate governance. Business, no doubt supplements society with goods, services, employment, and other facilities required and demanded in the society. Profit making is not at all an unethical act but by discarding the societal needs and requirements and by violating the law which is governing and prevailing while pursuing business is both unethical and illegal.

Mismanagement and corruptions are two possible difficulties that may arise in any company. To prevent such mismanagement and corruption, well established corporate governance is very important. However, name and fame earned by a company can be demolished by certain scams and frauds likely to take place in a company may affect the integrity and good will of the company. Scams, frauds, misappropriation of company funds etc may shatter the confidence of the investors and customers of the company. The corporate governance helps to save the company from such financial crisis and ethical damage that may arise in the company. Corporate governance must be strong and it can maintain investors' confidence in the matter of financial credibility to raise capital required for company's growth in an effective and efficient manner.

Very significant part of a company is its process of mergers, acquisitions, takeovers etc. During such process, creation of confusion, ethical issues, with the stakeholders are common in nature. To find solution to such issues, corporate governance helps the company and leads to take up appropriate decisions. Corporate governance in a company ensures success and economic growth of the worldwide.

The governance should be transparent enough regarding accounts and audits of the company because the investors focus on the growth rate and shares of the company and the status of profitability of it. The companies dealing with Foreign Investors, joint ventures, Overseas Corporate Bodies etc., including Foreign Direct Investment, need to have strong corporate governance with policy details.

3. Law Governing Corporate Governance

The concept of corporate governance has



come up in 1990's and it as initially framed by Industry Association on Confederation of Indian Institute. Narayana Murthy Committee and Naresh Chandra Committee also have taken up the task of adopting the system of corporate governance and working accordingly in the companies. The major efforts are made by the Securities and Exchange Board of India (SEBI) and the Ministry of Corporate Affairs, Government of India. The Mandatory Corporate Governance Voluntary Guidelines has been introduced in 2009 and Board of Directors, audit committees etc should follow the guidelines without any lapse.

To bring the changes in Companies Act 1956, the Act was amended in 2013 and adopted the features of corporate governance. The Institution of Company Secretaries of India also follows the system of corporate governance and the corporate social responsibility as per Section 118 of the Companies Act 2013.

In a corporate entity, openness and accuracy of data and information as per the rules and regulations governing the corporate sector is very important. Transparency and the accountability is the hallmark of the progress of a company. Regulations of Securities and Exchange Board of India (SEBI), Ministry of Corporate affairs, Companies Act 2013 etc. are prominent rule making and regulatory bodies of corporate sector in India.

The Securities and Exchange Board of India is a significant body in India to regulate malpractices likely to happen in the financial market and it also ensures protection to the investors in the security market. This authority has been established on 12th April, 1992 with the objective to regulate the activities of stock exchange and financial market. SEBI has developed the norms of corporate governance for the companies.

To strengthen the corporate governance, there are certain amendments are made in Clause 35B and Clause 49 of the Listing Agreement. During listing under stock exchange, companies and the stock exchange execute a document called listing agreement. Clause 35B provides for shareholders the option of e-voting on all proposed or passed

general meetings. If facility for e-voting is not utilised by them, they can opt for postal ballot voting. It helps to strengthen the Corporate Governance norms in India in special reference to the listed companies. As per amendment to Clause 49 of the Listing Agreement it helps to strengthen the Corporate Governance framework for Listed companies in India by revising the provisions related to independent directors and their stock options. It gave importance to ethics and law in the corporate sector. Listing agreement ensures the company with good governance.

The Companies Act, 2013 has been enacted on August 29th, 2013 which provides for a major overhaul in the Corporate Governance norms for all companies. The focus and objective of the Act is overhauling corporate governance. On 27th March 2014, a notification has been made about the corporate governance of the companies. The rules made under the Companies Act is made applicable to both the listed and unlisted companies.

Under the Companies Act, prospectus must be properly maintained and there must be disclosure of annual report of the company so that transparency and trust of stakeholders can be managed systematically. Under Companies Act, the audit committee does the function of review of ethics code along with other audit and accounts related works.

Ethics and law are closely connected and interlinked because, whatever is legal are usually considered as ethical in nature. But there are situations and instances wherein, all ethical matters are not legalised. For example, evasion of tax by any individual or by company is considered as both illegal and unethical, but avoidance of tax is done through legal way even though it is not ethical. Illegal acts are no doubt prohibited by law and considered as offence under the law. So, maintaining business ethics through corporate governance can enhance legal rules and regulations too.

4. Significance of Ethics in Corporate Governance

Ethics symbolises character, morality, and ideologies in the social system. Ethical and moral



values in business provides for legal sanctity and it denotes that business is free from fraud, scams, bribery, providing harmful goods to customers etc. The company shall conduct business with ethics to achieve prudence, to protect the interest of the business community, to keep its commitment towards society, to achieve the goals and fulfil the expectations of the stakeholders, to protect the reputation of the company etc.

Business ethics is nothing but rules of business conduct and ethical behaviour dictated by the society as well as social policies. Ethics in a company operates through conscience and the corporate ethics and societal ethics work through the system of scrutiny both internally and externally, both must be reinforced by mechanisms for enforcement. To maintain ethics in a company or establishment, there must be good corporate governance. The corporate governance under the Companies Act 2013 plays a vital role in the matter of Board of Directors, their composition, number of directors in a public and private company, existence of women directors, resident director, independent director, different committees under the Companies Act like audit committee, stakeholders' relationship committee, internal audit etc. It also highlights on corporate social responsibility, its policy and committee. The corporate social responsibility has ethical and moral significance because the company extends its helping hand to the under privileged and poor people in the projects and works undertaken by the government. During the crisis or pandemic if a company comes forward to assist the government in providing the resources to the needy and helping in social and economic upliftment of the people who are in sufferings, it can contribute to the company's ethical standards.

To comply all legal rules and regulations Board of Directors are necessary in a company. Section 149 of the Companies Act 2013, narrates that minimum three Board of Directors are to be there in a public company and minimum two in a private company is the mandatory requirement. In the newly amended Act mandatory appointment of women directors is prescribed to the listed company, unlisted company, and public company with paid up share capital of Rs. 100 crores or more

with the turnover of Rs. 300 crores or more. There must be a resident director in a every company who is residing in India not less than 182 days in a year. Appointment of independent directors is mandatory to the company and they play a prime role in resolving the issues of shareholders and investors.

In the company's code of conduct, the Board sets out code of ethics and business ethics for all directors and members of the company and staffs. Under Companies Act the concept of whistleblower mechanism. It deals with vigilance mechanism to the directors and the employees of the company specifically concerned to the unethical behaviour, fraud, or violation of ethical code.

Ethical and moral liability arises for a corporate sector or company when there arises violation of the confidence and expectations of the stakeholders. Ethics in business is measured with the conception of right or wrong or the actions are moral or immoral. Business with ethics in a company is expected by the public and society and it also enhances quality of relations among employees, shareholders, improves profitability, protects employees from the unjust actions of the employers, etc. Ethical problems arise in a company because of selfish nature, pressure of increasing the profit, conflict between personal values and business goals etc.

In global level, there is growing concerns on our planet and environment and sustainable development. If the companies, corporate entities, themselves equip social and environmental concerns and the companies present their environmental credentials, it would represent their ethical standards and moral value of the company. The corporate governance can look after such matters and along with profitability, company can also enhance the value by concentrating on charity, environmental protection, social and public welfare and internal ethical codes and standards.

Board room is a place from where the business ethics begins and some times the responsibility of maintaining ethical codes and standards are shifted to the system itself and they formulate ethical codes for the company. In India there are major ethical



problems that are arising in a company is political and administrative issues. Need of political support for a company may make them inevitable to accept political pressure and administrative malpractices also contributes to ethical trouble inside the company.

The very fundamental concept of ethics arises in the establishment of a company with trust and confidence. During 19th Century, the limited liability companies are established with the concept of trust and stewardship. But the power when shifted from the owners to the hands of directors regarding the administration and look after of the company, ethical principles also has taken the turn. Later in 1970's profit became the major motive by over taking ethical significance. There arises a question as to how the companies maintain ethics and policies relating to ethics in the company. For that, companies implement ethical behaviour inside the company by publishing inhouse code of ethics and the members are strictly instructed to follow the same.

There may arise certain situations to force any manager or employee, or director of a company to take up unethical way of conducting business. The matter of promotion system, budget pressure, competitions etc in the company may find someone to step in the path of unethical business yet it is not healthy to go in such deviated path.

5. Instances of Failure of Corporate Governance

If the corporate governance fails in a company there will be lot of repercussions by it. There is possibility of tax evasion by the company which leads to penal actions and the reputation of the company shatters. Sometimes, malpractice occurs inside the company and it affects the stakeholders and investors of the company. If ethical standards are not

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high, there is possibility of failure of corporate governance like lack of transparency, conflict of interests between the board and the management, lack of risk management system, corruption, and fraud etc. All these may result in loss of employment, financial loss and total damage to the reputation of the company. Sathyam scandal occurred in 2009 is the biggest example where Indian company failed in corporate governance system in which Ramalinga Raju cheated the investors through IT sector. In 1990's Harshad Mehta issue is one of the best example for failure of corporate governance and he has deceived many investors in stock exchange sector specifically on Bombay Stock Exchange (BSE Sensex). Even Kingfisher Airlines also experience poor corporate governance and failed. One more stock market related failure is Ketan Parekh case in which he has collected lot of amounts from the promoters of different companies in the name of insider trading and totally created trouble and scam. Saradh Chit Fund case also a result of failure of corporate governance in which Saradh group issued debentures by violating SEBI rules completely and created a scam. Other than theses many other scams and failure of corporate governance have taken place worldwide. So, corporate governance must be strong enough to combat such problems and uphold business ethics in the administration and management of company.

6. CONCLUSION

By the detailed study on the topic, it is very much evident that, even though profit making and economic excellence is the main concern of any business establishment or enterprise, social responsibility, business ethics, morality in conducting business is must. Following rules and regulations, bye-laws and other policy procedures are also very significant part of a corporate business. Company also a person but artificial person and it must follow ethics and strong corporate governance can build powerful and efficient company.



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