Models of Corporate Governance

Corporate governance models differ globally based on legal, cultural, and economic systems. Each model reflects varying priorities among shareholders, employees, and other stakeholders.

1. Anglo-American Model (Focus on Shareholders)

- **Key Features**:
  This model emphasizes maximizing shareholder value and prioritizes the interests of equity investors. It is prevalent in countries like the U.S. and the UK, where capital markets play a critical role.
- **Structure**:
  The board of directors is central, and shareholders hold significant power in electing board members. CEOs often have a strong influence on decisions.
- **Characteristics**:
  - Strong focus on transparency and accountability to investors.
  - High reliance on stock markets for financing.
  - Short-term financial performance is often prioritized.

2. Continental European Model

- **Key Features**:
  Found in countries like Germany and France, this model emphasizes a balance between shareholders and stakeholders, including employees and creditors.
- **Structure**:
  Often characterized by a two-tier board system:

- **Supervisory Board**: Represents shareholders and employees, ensuring oversight.
- **Management Board**: Handles day-to-day operations.

- **Characteristics**:
  - Long-term stability is prioritized over short-term gains.
  - Banks and other financial institutions play a significant role in governance.

3. Scandinavian Model (Focus on Employee Welfare)

- **Key Features**:
  Common in Nordic countries like Sweden and Denmark, this model integrates corporate governance with employee welfare and social responsibility.
- **Structure**:
  Employees often have a strong representation on the board, fostering collaboration between labor and management.
- **Characteristics**:
  - Emphasis on sustainability and long-term value creation.
  - High levels of trust and transparency within organizations.
  - Strong welfare policies that align corporate goals with employee well-being.

4. Asian Model

- **Key Features**:
  Corporate governance in Asia, particularly in countries like Japan, China, and South Korea, often centers around family-owned businesses or large conglomerates.

- **Structure**:
    - In Japan, the "keiretsu" system focuses on interlinked companies with cross-shareholding.
    - In China, state-owned enterprises (SOEs) dominate, with the government playing a key role in governance.
- **Characteristics**:
    - Long-term relationships with stakeholders, especially banks and suppliers.
    - Strong focus on harmony and consensus in decision-making.
    - Less emphasis on shareholder activism compared to Western models.

5. Emerging Market Model

- **Key Features**:
  In emerging economies like Brazil, India, and South Africa, governance models are evolving to balance stakeholder interests with shareholder value.
- **Structure**:
  Governance structures are often influenced by foreign investors and global standards, but they also face challenges like corruption and weaker regulatory frameworks.
- **Characteristics**:
    - Emphasis on improving transparency and combating corporate misconduct.
    - Varied governance practices due to cultural and institutional differences.

- Growing focus on environmental, social, and governance (ESG) criteria.

6. Global Emergence Model

- **Key Features**:
  With globalization, companies increasingly adopt hybrid governance practices, blending local traditions with international standards.
- **Structure**:
  Multinational corporations often adapt governance models to align with both home and host country requirements.
- **Characteristics**:
  - Strong focus on sustainability and ESG principles.
  - Adoption of international governance codes like the OECD Principles.
  - Increased collaboration among global stakeholders, balancing local and international expectations.

UK: Cadbury Committee (1991)

The Cadbury Committee was established in 1991 to address corporate governance concerns in the UK, focusing on accountability, transparency, and ethical management practices. Its recommendations formed the foundation of the UK's corporate governance code. Key aspects include:

1. Board Composition and Independence

- The committee emphasized a balance of executive and non-executive directors (NEDs) on the board to ensure impartial oversight and effective decision-making.
- Non-executive directors were recommended to be independent and bring objective judgment, free from conflicts of interest.

2. Roles and Responsibilities of Directors

- Directors are accountable for ensuring that the company operates in the best interests of its shareholders while adhering to ethical and legal standards.
- The committee stressed the importance of directors understanding their fiduciary duties and maintaining transparency in corporate operations.

3. Financial Reporting and Internal Control

- Accurate and transparent financial reporting was highlighted as a cornerstone of good governance.
- Companies were required to establish robust internal control systems to prevent fraud, detect errors, and maintain the integrity of financial statements.

4. Shareholder Rights and Engagement

- The Cadbury Committee emphasized the need for companies to respect and uphold shareholder rights.
- Encouraging active shareholder engagement, the committee recommended clear communication of company performance and strategy through meetings and reports.

5. Ethical Standards

- The committee underscored the importance of ethical leadership, promoting integrity and accountability at all levels of the organization.
- Directors were tasked with setting the tone for ethical behavior, ensuring compliance with laws and regulations, and building trust with stakeholders.

US: Sarbanes-Oxley Act (SOX) 2002

The Sarbanes-Oxley Act was enacted in response to major corporate scandals like Enron and WorldCom. It aimed to restore public trust in corporate governance and financial reporting by enhancing accountability, transparency, and legal compliance. Key provisions include:

1. Public Company Accounting Oversight Board (PCAOB)

- The PCAOB was established to oversee the audits of public companies and ensure compliance with strict auditing standards.
- It regulates auditors, conducts inspections, and enforces disciplinary actions to maintain the integrity of financial reporting.

2. Auditor Independence

- The Act mandates the independence of external auditors to prevent conflicts of interest.
- Provisions include restrictions on non-audit services provided by auditors to their clients and mandatory auditor rotation to prevent long-term relationships that could compromise objectivity.

3. Whistleblower Protection

- SOX includes provisions to protect employees who report corporate fraud or violations of securities laws.
- Whistleblowers are safeguarded against retaliation, including demotion, firing, or harassment, and are entitled to seek legal remedies if mistreated.

4. Criminal and Civil Penalties

- The Act imposes severe penalties for corporate fraud, misrepresentation of financial statements, and destruction of evidence.
- Executives can face significant fines and imprisonment for non-compliance, emphasizing accountability at the highest levels of management.

OECD Principles of Corporate Governance

The OECD Principles of Corporate Governance provide a global benchmark for fostering transparency, accountability, and fairness in corporate governance. They aim to support sustainable economic development by guiding companies and policymakers.

1. Ensuring the Basis for an Effective Corporate Governance Framework

A sound legal and regulatory framework is essential for effective governance. It should promote transparency, fairness, and accountability, providing clear responsibilities for all stakeholders involved in corporate governance.

2. Rights and Equitable Treatment of Shareholders

Shareholders should have the right to vote, receive timely information, and participate in decision-making processes. Companies must treat all shareholders equitably, preventing abuses by majority or insider stakeholders.

3. Institutional Investors, Stock Markets, and Other Intermediaries

Institutional investors and intermediaries should act responsibly and transparently. Effective oversight of market intermediaries ensures that their activities align with the broader goals of corporate governance.

4. Role of Stakeholders in Corporate Governance

Corporate governance frameworks should recognize stakeholder rights, including employees, customers, and creditors, ensuring ethical behavior and fostering long-term success through cooperation and trust.

5. Disclosure and Transparency

Companies must provide accurate and timely disclosure of all material information, including financial performance, ownership structures, and governance practices, to build trust and accountability with stakeholders.

6. Responsibilities of the Board

The board is accountable for overseeing the company's operations, ensuring strategic direction, risk management, and ethical conduct. Boards should act in the best interest of the company and its stakeholders.

Indian Experience: Recommendations of Corporate Governance Committees

India's corporate governance framework has evolved through the recommendations of various committees aimed at improving transparency, accountability, and stakeholder protection.

CII Code of Best Practices (1998)

The **Confederation of Indian Industry (CII)** developed India's first voluntary corporate governance code, laying the foundation for improved transparency, accountability, and fairness in business practices. Its recommendations were designed to foster trust and confidence among stakeholders.

Key Recommendations

1. Board Composition and Independence

Recommended a mix of executive and non-executive directors to ensure balanced decision-making and independent oversight.

2. Role of Independent Directors

Encouraged the inclusion of independent directors to bring unbiased perspectives and protect minority shareholders' interests.

3. Financial Disclosures

Advocated for comprehensive and timely financial reporting to enhance transparency and build trust with stakeholders.

4. Audit Committees

Proposed forming audit committees with independent directors to oversee financial reporting and internal controls effectively.

5. Shareholder Rights

Stressed the importance of equitable treatment of all shareholders and greater participation in key decision-making processes.

Kumar Mangalam Birla Committee (1999)

The Kumar Mangalam Birla Committee was set up by SEBI to enhance corporate governance in India, with a focus on ensuring accountability, transparency, and protecting shareholder interests.

Key Recommendations:

1. Board of Directors (BOD)

- If the chairman is a non-executive director, at least one-third of the board should be independent directors.
- If the chairman is an executive director, at least half of the board should be independent directors. This ensures adequate oversight by independent members

2. Audit Committee

- The audit committee should have a minimum of three members, all non-executive directors, with at least half being independent.
- The committee should meet at least once every six months.
- Powers include investigating any matter, appointing external legal experts, and overseeing financial statements to ensure accuracy and transparency.

3. Remuneration Committee

- The remuneration committee is responsible for setting salaries, incentives, pension schemes, notice periods, provisions, and stock options for directors.

- The composition of the remuneration committee should be similar to the audit committee, ensuring independence and fairness.

4. Shareholders

- Emphasized the importance of protecting shareholders' rights, ensuring their participation in decision-making, and maintaining fairness in all dealings.

5. Corporate Governance Disclosures

- Companies should provide both qualitative and quantitative information in their disclosures, ensuring transparency in business operations and financial performance.

Naresh Chandra Committee (2002)

The Naresh Chandra Committee was set up to enhance the quality of corporate governance in India, focusing on improving auditor independence and the integrity of financial reporting.

Key Recommendations:

1. Disqualification of Audit Assignments

- The committee recommended stricter criteria for the disqualification of auditors from taking on assignments, to prevent conflicts of interest and ensure unbiased financial reporting

2. Prohibited Non-Audit Services

- To maintain auditor independence, the committee recommended that auditors should not provide non-audit services to the companies they audit, preventing any potential conflict of interest.

3. Compulsory Rotation of Auditors

- The committee proposed the mandatory rotation of auditors for companies with share capital and reserves exceeding ₹10 crore or turnover exceeding ₹50 crore.
- The rotation should occur every five years, with at least 50% of the audit committee members changed to enhance objectivity.

4. Disclosure of Contingent Liabilities

- It recommended that companies disclose contingent liabilities clearly in their financial statements to ensure full transparency about potential risks and obligations.

5. CEO and CFO Certification

- The committee suggested that CEOs and CFOs certify the financial statements, ensuring accountability for the accuracy and integrity of the reports before submission to stakeholders.

6. Independent Quality Review Board

- The committee proposed establishing an independent body to review the quality of audits, ensuring that auditors maintain the highest standards and avoid malpractices.

7. More Than 50% Independent Directors

- It recommended that at least 50% of the board members should be independent directors to ensure greater oversight and reduce the risk of management entrenchment.

8. Role of ICAI (Institute of Chartered Accountants of India)

- The committee emphasized the need for the ICAI to take a more active role in enforcing high standards of auditing and corporate governance to protect the integrity of financial reporting.

Narayana Murthy Committee (2003)

The Narayana Murthy Committee reviewed and enhanced **Clause 49** of the listing agreement, proposing further measures to improve corporate governance in India. The committee emphasized transparency, protecting minority shareholders, and reinforcing the role of independent directors.

Key Recommendations:

1. **Stricter Definitions and Roles for Independent Directors**
    - The committee recommended clearer definitions of independent directors and more specific guidelines for their roles and responsibilities, ensuring better oversight and accountability within boards.
2. **Whistleblower Policy**
    - A key recommendation was the implementation of a whistleblower policy, allowing employees to report unethical practices confidentially and without fear of retaliation, promoting transparency within organizations.
3. **Enhanced Risk Management Practices**
    - The committee stressed the importance of incorporating robust risk management frameworks to identify, assess, and mitigate risks proactively, ensuring companies are better prepared to handle financial and operational challenges.
4. **Protection of Minority Shareholders**
    - It highlighted the need for stronger safeguards to protect the interests of minority shareholders, ensuring they are not disadvantaged by decisions made by majority shareholders or management.

5. **Strengthening Audit Committees**
    - The committee recommended further strengthening of audit committees, ensuring they have the necessary authority and independence to effectively oversee financial reporting and internal controls.
6. **Enhanced Disclosure Requirements**
    - The committee proposed stricter disclosure norms to increase transparency, particularly in financial reporting, executive compensation, related party transactions, and risks associated with the business.

Kotak Committee (2017)

The Kotak Committee aimed to align Indian corporate governance practices with global best practices, focusing on increasing transparency, accountability, and strengthening board independence.

Key Recommendations:

1. **Independent Director Appointments**
    - The committee recommended enhancing the process of appointing independent directors to ensure a more transparent and accountable selection process, including a broader search for qualified candidates.
2. **Disclosure of Expertise/Skills of Directors**
    - It suggested that companies disclose the specific expertise and skills of their directors, providing stakeholders with better insight into the capabilities of the board.
3. **Enhanced Role of Committees**
    - The committee recommended strengthening the roles of audit committees, nomination and remuneration

committees, and risk management committees to ensure better oversight and corporate governance.

4. **Reduction in the Maximum Number of Directorships**
    - It proposed limiting the number of listed entity directorships a person can hold to ensure that directors can dedicate sufficient time and attention to each role.
5. **Permission for Related Parties to Vote Against Related Party Transactions (RPT)**
    - To prevent conflicts of interest, the committee suggested allowing related parties to vote against related party transactions to ensure fair approval processes.
6. **Mandatory Disclosure of Consolidated Quarterly Results**
    - Starting from FY 2019-2020, companies would be required to disclose consolidated quarterly results, providing more comprehensive financial information to stakeholders.
7. **Mandatory Secretarial Audit**
    - The committee recommended making secretarial audits mandatory for listed companies and their material unlisted subsidiaries to ensure compliance with corporate governance standards.
8. **Separation of CEO/MD and Chairperson Roles**
    - To enhance the independence of the board, the committee suggested separating the roles of CEO/MD and the chairperson of the board.
9. **Board of Directors Quorum**
    - The committee recommended that the quorum for board meetings be the higher of three directors or one-third of

the total board strength, with the board size being at least six directors.

10. **Annual General Meeting (AGM)**

    - The committee proposed that AGMs should be held within five months, instead of the current six months, and that proceedings should be webcast live to ensure transparency and wider access for shareholders.

SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015

The SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, were established to enhance transparency, accountability, and good governance practices in listed entities. The regulations specifically address the composition and role of the Board of Directors and the responsibilities of independent directors.

Composition and Role of the Board of Directors

- **Composition**:
    - The board must have a mix of executive and non-executive directors, with at least one-third of the board being independent directors in case the chairperson is a non-executive director. If the chairperson is an executive director, at least half the board should consist of independent directors.
    - The board should also include a diversity of expertise, skills, and experience to contribute to decision-making in various areas such as finance, law, business, and governance.

- **Role**:
  - The primary role of the Board of Directors is to oversee the company's management and ensure the protection of shareholder interests.
  - They are responsible for formulating business strategies, overseeing corporate performance, and ensuring compliance with legal and regulatory requirements.
  - The board should meet at least four times a year, with a gap of not more than 120 days between two meetings, ensuring adequate oversight and timely decision-making.

Role of Independent Directors

- **Definition**:
  - Independent directors are non-executive directors who do not have any material relationship with the company or its management, except for receiving director fees. They must act independently of management and protect the interests of minority shareholders.
- **Responsibilities**:
  - **Oversight**: Independent directors play a key role in monitoring the management's performance and ensuring that the company operates in compliance with laws and ethical standards.
  - **Corporate Governance**: They are responsible for upholding strong corporate governance practices, especially in matters relating to financial reporting, internal controls, and risk management.
  - **Audit and Risk Committees**: Independent directors are crucial members of committees such as the audit committee, risk management committee, and nomination

& remuneration committee, where they ensure the objectivity and transparency of the company's financial statements and executive compensation.

- **Protecting Minority Shareholders**: Independent directors act as a safeguard for the interests of minority shareholders, ensuring that they are not exploited or excluded from decisions that affect their rights and investments.