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# **CORPORATE GOVERNANCE AND ETHICS** **UNDER THE COMPANIES ACT, 2013 : A Study**

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## **ABSTRACT**

Business Ethics/ Corporate Ethics is the study and evaluation of decision making by the Corporations according to moral concepts and judgements. The initiative to effectively introduce Corporate Governance was taken up by Naresh Chandra Committee and Narayan Murthy Committee who previewed Corporate Governance model working in Companies from the viewpoint of shareholders investors and other stakeholders of the Company.

The real change in the corporate sector could be felt with the introduction of 2009 Mandatory Corporate Governance Voluntary Guidelines which has to be complying by companies listed on stock exchange by Clause 49 of Listing Agreement. The final assent to Corporate Governance practices in the effective management of the company can be seen as introduction to new significant provisions introduced in the Companies Act, 2013 in form of independent directors, women directors on the board, corporate social responsibility and mandatory compliance of Secretarial Standards issued by Institute of Company Secretaries of India as per Section 118 of Companies Act, 2013.

The main theme of corporate governance is to integrate sound management policies in the corporate framework in such a manner to bring economic efficiency in the organization to achieve twin goals of profit maximization and shareholder welfare.

Human values are rooted in virtues which are difficult to monitor, measure and quantify. Therefore, 'Principle Centred' corporate guidelines are encouraged to replace 'Rule based' ones. Ethical governance has become an important issue in the context of unethical behaviour and malpractices by the corporate houses.

**KEY WORDS:** Company Law – 2013, Corporate Governance/ Ethics

## **Introduction**

The 'Corporate Ethics' is also called as the "Business Ethics". The Business Ethics/ The Corporate Ethics is the study and evaluation of decision making by the Corporations according to moral concepts and judgements. The Corporate Ethics range from practical, narrowly defined issues, such as Company's obligation to be honest with its customer, to broader social and philosophical questions, such as company's responsibility to preserve the environment and protect employee's rights. In other words, "The application of a moral code of conduct to the strategic and operational management of a business" is Corporate Ethics.

Corporate Governance is the new golden term coined in the Corporate Sector in the late 1990 by the Industry Association on Confederation of Indian Industries as a voluntary measure to be adopted by the Indian Companies. The initiative to effectively introduce Corporate Governance was taken up by Naresh Chandra Committee and Narayan Murthy Committee who previewed Corporate Governance model working in Companies from the viewpoint of shareholders investors and other stakeholders of the Company. Corporate Governance guidelines both mandated and voluntary have evolved since 1998 due to the sincere efforts of several committees appointed by the Ministry of Corporate Affairs and SEBI. The real change in the corporate sector could be felt with the introduction of 2009 Mandatory Corporate Governance Voluntary Guidelines which has to be complying by companies listed on stock exchange by Clause 49 of Listing Agreement. The final assent to Corporate Governance practices in the effective management of the company can be seen as introduction to new significant provisions introduced in the Companies Act, 2013 in form of independent directors, women directors on the board, corporate social responsibility and mandatory compliance of Secretarial Standards issued by Institute of Company Secretaries of India as per Section 118 of Companies Act, 2013.

## **Objectives of the Study**

The objective of the present study is to discuss some theoretical aspects of Corporate Governance and to highlight the provisions of the Companies Act 2013 relating to corporate governance.

## **Methodology**

It's purely a theoretical paper based on information collected from different sources like law books, journals etc. The author proposes that some theoretical aspects of corporate governance to be discussed in the primary stages of 'discussion and analysis' part of this paper and then present the key features of company act 2013 relating to corporate governance. Finally, a

conclusion will be drawn based on discussion and analysis.

### **Discussions and Analysis**

Corporate Governance is a multi-faceted subject and difficult to comprehend in a concise definition. The main theme of corporate governance is to integrate sound management policies in the corporate framework in such a manner to bring economic efficiency in the organization to achieve twin goals of profit maximization and shareholder welfare.

#### **Need of Corporate Governance:**

The collapse of international giants like Enron, WorldCom, Tyco, AOL, and financial scams like Satyam have been big eye-openers in the corporate arena to make realize the company's management, ownership, and stakeholders the emergent need to comply with Corporate Governance principles in order to prevent themselves from paying huge corporate criminal liabilities in the future. These huge corporate giants paid the cost for lack of good corporate governance practices and corrupt policies adopted by management of these companies and their financial consulting firms. The significance of good corporate governance solutions has widened because of the increasing conflict between ownership and management disciplines, the non-compliance of financial reporting by auditors which inflicts heavy losses on investors and lack of fair and transparent culture in the company which shook's investor trust in the financial viability of the company and its ethical standards.

Human values are rooted in virtues which are difficult to monitor, measure and quantify. Therefore, 'Principle Centred' corporate guidelines are encouraged to replace 'Rule based ones'<sup>1</sup>. Ethical governance has become an important issue in the context of unethical behaviour and malpractices by the corporate houses.

#### **Scope of Corporate Governance:**

Corporate governance instills ethical standards in the company. It creates space for open dialogue by incorporating transparency and fair play in strategic operations of the corporate management. Key Market Players Involved in Corporate Governance: The Corporate management decisions have an impact on various people and entities associated with the company who are collectively known as stakeholders which include shareholders, directors, creditors, employees, suppliers,

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<sup>1</sup> Ethical Governance and the role of Company Secretaries: A Comprehensive Review

government agencies and society at large. But there are only key stakeholders like shareholders, directors, officers who are active participants in corporate governance process and other stakeholders who themselves are not involved in corporate governance practices but rather are recipients of benefits derived from companies having good corporate governance practices.

### **Corporate Ethics towards the people:**

The primary objective of a corporation is to earn profits; however the corporations should conduct their business in a healthy manner. There are several cases which shows that some of the corporations very badly behaved and neglected their duties towards the people. <sup>2</sup>Some of the leading cases are (Reddy, 2014):

- (a) Union Carbide Corporation Vs. UoI (1991), 4 SCC 584 : Bhopal Gas Leak Disaster case.
- (b) M.C Mehta and another Vs. Shri Ram Foods and Fertilizer Industries (AIR 1987 SC 965) : Oleum Gas Leak Case
- (c) Indian Council for Enviro-Legal Action and others Vs.UoI & Others (1996 – SCC 212): H-Acid & Chemical Case)
- (d) Narula Dyeing and Printing Works Vs. UoI (AIR 1995 Guj 185): Effluent Treatment Pollution Case.

Even after three decades, in some of the cases the victims are not paid the appropriate compensations. Here at this juncture, the Corporate Ethics must be followed by every corporation not to cause the environmental pollution.

### **Corporate Ethics towards the consumers:**

The manufacturers of the goods have special duty towards their consumers. Donoghue Vs. Stevenson (1932 AC 562) is a famous case in the Law of Torts which laid down Manufacturers Liability for Negligence – Neighbor Rule. There are several statues such as The Food Safety and Standards Act, 2006; the Prevention of Food Adulteration Act, 1954, the Weight and Measurement Act, 1976 etc. have been imposing the civil and criminal liabilities against the wrong doers. Here at this juncture, the Corporate Ethics must be followed by every corporation

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<sup>2</sup> Sujatha Law Series by Gade Veera Reddy

to supply the hygienic foods and goods.

### **Corporate Ethics towards its own employees:**

Every corporation must treat its employees in harmonious terms. They are the foundation of every industry. There are laws and rules regulating the management and workmen relations. The laws and rules are different from the ethics. Moral ethics must be combined with the laws and rules to improve the quality and quantity of the goods and services.

### **Social Accountability:**

Corporate ethics include social accountability. It is a concept describing the communications of social and environmental effects of a company economic action to particular interest groups within the society and to the society at large.

Therefore, the Corporations are liable to follow the Corporate / Business Ethics. The very least corporation can do is to be honest about what it does each day.

### **Key Features of Corporate Governance in Companies Act, 2013**

The new Companies Act, 2013 has introduced various key provisions which have changed the corporate regime in such a way to run the corporate machinery in alignment with the globalised corporate world by mandatory disclosure requirements for<sup>3</sup>:

#### **1. Independent Director under the Companies Act, 2013**

The strength of number of Independent Directors for the prescribed companies under Section 149(4) read with Rule 4 of Companies (Appointment and Qualifications of Directors) Rules, 2014 for listed Public Company is at least one third of total number of directors and public companies having turnover of 100 crores rupees or more at least 2 directors and public companies having paid up capital of 10 crores rupees or more at least two directors.

#### **2. Audit Committee**

1. The Audit Committees of the Companies Act, 2013 has undertaken both private and public companies within its ambit to constitute audit committees. The constitution of audit committee has also seen change as compared to clause 49 with minimum with three

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<sup>3</sup> International Journal of Multidisciplinary Studies, Vol. III, No.2, October, 2018

independent directors on the board along with the chairperson who should be able to read and understand the financial statement.

2. Section 177 of the Companies Act, 2013 and Rule 6 and 7 of Companies (Meetings of Board and its Powers) Rules, 2014 deals with the Audit Committee.

3. The Board of directors of every listed company and the following classes of companies, as prescribed under Rule 6 of Companies (Meetings of Board and its powers) Rules, 2014 shall constitute an Audit Committee.

I. All public companies with a paid-up capital of Rs. 10 Crores or more;

II. All public companies having turnover of Rs. 100 Crores or more;

### 3. Internal Audit

Companies Act, 2013 has mandated the internal audit for certain classes of companies as specified under Section 138 of the Companies Act, 2013.

### 4. Serious Fraud Investigation Office (SFIO)

Section 211 (1) of the Companies Act, 2013 shall establish an office called the Serious Fraud Investigation office to investigate fraud relating to Company. The powers are given to SFIO under the act as mentioned that he can investigate into the affairs of the company or on receipt of report of Registrar or inspector or in the public interest or request from any Department of Central Government or State Government.

### 5. Corporate Social Responsibility

The concept of CSR rests on the good corporate citizenship where corporate contributions to societal growth as a part of their corporate responsibility for utilizing the resources of the society for their productive use. The Ministry of Corporate Affairs has recently notified Section 135 and Schedule VII of the Companies Act as well as the provisions of (CRS Rules) which has come into effect from 1 April 2014.

### **Applicability**

Section 135 of the Companies Act provides the threshold limit for applicability of the CSR to a Company:

1. Net worth of the company to be Rs. 500 crore or more;
2. Turnover of the company to be Rs. 1000 crore or more;
3. Net profit of the company to be Rs. 5 crore or more.

Further, as per the CSR Rules, the provisions of CSR are not only applicable to Indian companies but also applicable to branch offices of a foreign company in India.

### **CSR Committee and Policy**

Every company as prescribed in Section 135 of the Act and Company (Corporate Responsibility) Rules, 2014 within the threshold limit requires spending of at least 2% of its average net profit for the immediately preceding 3 financial years on CSR activities. Further, the company will be required to constitute a committee (CSR Committee) of the Board of Directors (Board) consisting of 3 or more directors. The activities which may be included by companies in their Corporate Social Responsibility Policies Activity relating to :

- (i) Eradicating extreme hunger and poverty.
- (ii) Promotion of education
- (iii) Promoting gender equality and empowering women.
- (iv) Reducing child mortality and improving maternal health
- (v) Combating human immune deficiency virus, and other diseases
- (vi) Ensuring environmental sustainability
- (vii) Employment enhancing vocational skills
- (viii) Social business projects
- (ix) Contribution to the Prime Minister National Relief Fund set up by the Central Government or the State Government for socio economic development and funds for the welfare of Scheduled Caste, the Scheduled Tribe and other Backward Classes, minorities and Women.

### **Conclusion**

The study reveals that the Companies Act, 2013 empowers independent directors with proper checks and balances so that such extensive powers are not exercised in an unauthorized manner but in a rational and accountable way. The Directors must balance the ideal against the practical – the need to get a reasonable profit for the company's shareholders with honesty in business practices, safety in the workplace and larger environmental and social issues. However, the corporate ethics issues in business have become more complicated because of the global and

diversified nature of many large corporations and because of the complexity of Government laws and regulations that define the limits of criminal behavior. It is our duty to encourage the corporations including the MNCs to adhere to ethical standards.

As brought by the other researchers as well, the changes are a step forward in the right direction to smoothly run the management and affairs of the companies in the interest of stakeholders. These are all welcome changes in the globalized corporate world of today and they will strengthen the core corporate machinery by introducing strong corporate governance norms in a company leading to economic efficiency and higher ethical standards which will always inspire the company's management to work in the direction to uphold its goals of maximization of wealth of stakeholders backed with good corporate repute.

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