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# COMPARATIVE ANALYSIS OF CORPORATE GOVERNANCE IN INDIA AND USA

**Nikita Mittu***

**Abstract**

*Corporate Governance is the process of ensuring that management activities take place with transparency and efficiency. It is the responsibility of the Board of Directors of a company towards the shareholders. It is required to incorporate a culture which ensures maximization of the visions and mission of the company in relation to its performance.*

*This paper will discuss the concept of Corporate Governance, its origins in the international market and the process of Internal Governance in markets of India and United States of America. It further discusses Corporate Governance practices followed by companies in India and USA, thereby analysing the similarities and the difference between the two established legal systems, including internal control, Committees, Independent Director and their duties and Audit Committee. Furthermore, this paper discusses the cases which led to the need for Corporate Governance in India and USA and established the legal provisions for the same. In the conclusion, the paper gives a summary of the provisions of Corporate Governance in India and USA in relation to its implementation ad impact.*

## INTRODUCTION

Corporate governance is the method of creating effective relationships to ensure corporate direction of the company. The main responsibility of corporate governance i.e. the oversight and control of management activities hence lies on the Board of Directors of the company, who are appointed by the shareholders. As we come down from the managerial graph of any company, responsibilities are diluted along the graph. Further, additional participation to corporate governance lies upon the shareholders, who appoint the Directors, employees, the creditors and suppliers. A Board of the company has numerous responsibilities related to

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management of the business and reporting the same to the shareholders. Hence, Corporate Governance is the responsibility and work accomplished by the board of directors of a company in order to ensure effective functioning of the corporation to yield maximum value of the company.

Thus, Corporate Governance, hence essentially revolves around the board of directors of a company. It provides structure and directly affects the performance of the company.[1]

## Academic and Legal Definitions

Organisation for Economic Co-operation and Development (OECD) defines 'Corporate Governance' as the "procedures and processes according to which an organisation is directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among the different participants in the organisation – such as the board, managers, shareholders and other stakeholders – and lays down the rules and procedures for decision-making."[2]

'Corporate Governance' is defined by Institute of Company Secretaries of India as, "the application of best management practices, compliance of law in true letter and spirit and adherence to ethical standards for effective management and distribution of wealth and discharge of social responsibility, for sustainable development of all stakeholders".[3]

"The act of steering, guiding and piloting—describes what boards [should] do when in session. It does not describe and is not a proxy for the board itself, nor any other party or activity outside the boardroom. Regulators (to set rules), proxy advisers (lobbyists on behalf of shareholders and other interests), and shareholder meetings (communications) are all important, but none is corporate governance."[4]

Further, corporate governance acts as an accountability to capital generators and investing agencies.[5] It is the management's control which ensures effective functioning of the

1 James McRitchie, 8/1999.

2 Annual Report, European Central Bank, 2004 (Aug. 04 2020, 2:35 PM), https://stats.oecd.org/glossary/detail.asp?ID=6778.

3 Smita Jain, Corporate Governance — National and International Scenario, (Aug. 04. 2020, 2:42 PM), https://www.icsi.edu/media/webmodules/programmes/33nc/33souvearticle-smitajain.pdf.

4 Peter Crow, *Corporate governance: Is our understanding flawed?*, (Mar. 12, 2020, 10:05 AM), https://www.petercrow.com/musings/on-corporate-governance-is-our-understanding-flawed.

5 Bruce Weber, Dean of the Lerner College of Business at the University of Delaware, at the inaugural meeting in November of the newly reconstituted advisory board for the John L. Weinberg Center for Corporate Governance.

company by working in its best interest and making the shareholders accountable to elect directors and auditors.

Corporate governance is generally the practice which affects the control of a business in a company. It not only affects the persons who control the companies but the allocation of risks and returns from the business of the company to persons including stockholders and directors.[6]

## Concept of Corporate Governance

When we talk about any corporation, the first aspect which comes to the mind is the goodwill of the company and output it generates. In order to ensure an impact on the public, investors as well as the shareholders, every corporation prepares its management with utmost care. Corporate governance is the set of rules and regulations which ensure an effective corporate functioning of any company which decides its existence and accountability in the market. It exhibits a balance between the interest of the stakeholders of the company and the public. It includes all aspects of management within its ambit including the internal controls and the disclosures required by a company in its functioning. Internal controls ensure that the financial and the accounting details of the company are reliable and the disclosure of the information at every level ensures transparency to the Board. The National Association of Corporate Directors (NACD) was established in the United States of America (USA) to ensure effective leadership in board of directors of the company.

NACD published 'Key Agreed Principles to Strengthen Corporate Governance for U.S. Publicly Traded Companies'[7] to improve the concept of corporate governance. Hence, it suggested that a Board of Directors shall be the first essential requirement to ensure 'long term value creation', thereby leading to transparency in the practices of the company to the shareholders. It suggested that directors of the Board should be from difference academic backgrounds to ensure diversity of skills and experience on the Board. This Board should be accountable to the shareholders only and shall be independent from the management of the company. [8]

6 Business Roundtable, *Principles of Corporate Governance,* (Apr. 04, 2020, 12:30 PM), https://corpgov.law.harvard.edu/2016/09/08/principles-of-corporate-governance/.

7 *Key Agreed Principles to Strengthen Corporate Governance for U.S. Publicly Traded Companies,* (Apr. 04, 2020, 12:46 PM), https://www.nacdonline.org/insights/publications.cfm?ItemNumber=2686.

8 Pallak Bhandari, *Corporate Governance: A Comparative Analysis in India and the US,* (Apr. 01, 2020, 11:30 AM), https://pdfs.semanticscholar.org/4a7d/6a7c1479c42f04227c61e1b0bd57ede189e6.pdf.

## Corporate Governance in India

Corporate Governance plays a crucial role in the economic condition of India. From 1991, the economy in India has seen a better size of the stock market.[9] For Indian market to ensure more foreign direct investments, the companies in India need to focus more on 'Shareholders value maximization'.[10] Although the concept and attempts of corporate governance has existed since 1961 globally, it is observed that only in 1992 did India take an initiative by reforming the Securities and Exchange Board of India (SEBI). SEBI ensured supervision and standardization of stock trading leading to formulation of corporate governance rules and regulations. Later, Confederation of Indian Industry (CII) was formed in 1996, which led to laws essential for companies in India to act for corporate governance.

Kumar Mangalam Birla Committee and Narayan Murthy Committee were formed, which were constituted under Securities and Exchange Board of India, whereby they were required to substantiate the meaning and importance of corporate governance for the companies in India. After an in-depth understanding and analysis of the companies, clause 49[11] was then introduced for listed companies with SEBI relating to listing contracts, which was later reformed after cases like Satyam, WorldCom, etc. to deal with issues which led to dismantling of these company's structure and management, thereby degrading the economy of the country.[12] Clause 49 of the Listing agreement provides for a minimum number of independent directors, board members, committees, code of conduct, audit committee rules and limitations, etc. Financial penalties were imposed on companies which did not follow the principles as laid down in Clause 49.[13]

On improving corporate governance in a company, the relation of the company with its stakeholders improves. Since corporate governance ensures that the property is protected

9 L. Som, *Corporate Governance Codes in India*, Economic and Political Weekly, vol. 41, no. 39, pp. 4153-4160, 2006.

10 R. Ramakrishnan, *Inter-relationship between business ethics and corporate governance among Indian companies*, International Seminar at The Institute of Management, NIRMA University, Ahmadabad, January 5-7, 2007,( Mar. 24, 2020, 01:30 PM), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1751657.

11 Clause 49 of the Listing Agreement by Securities Exchange Board of India (SEBI) is applicable to all the listed Companies under SEBI w.e.f. Oct. 01, 2014. It provides for listed companies to ensure optimum combination of directors in the Company including executive and non-executive directors and include at least one woman director. It essentially includes the rights of the shareholders, the responsibility of stakeholders and directors and the disclosures required by the company to maintain transparency.

12 N. Sanan and S. Yadav, *Corporate governance reforms and financial disclosures: A case of Indian companies*, IUP Journal of Corporate Governance, vol. 10, no. 2, pp. 62-81, 2011.

13 K. Han and Y. Lu, *Corporate governance reforms around the world and cross-border acquisitions*, Journal of Corporate Finance, 2013.

and the registration of ownership is effectively and securely done, this benefits the company's capital mobilization. In order to receive funds, the company requires to be transparent in their disclosure of funds. Companies have to ensure that the funds are received and are effectively allocated.[14]

## Clause 49 of the Listing Agreement

Clause 49 of the Listing Agreement is the agreement between the company and the stock exchanges on which it is listed, such as National Stock Exchange and Bombay Stock Exchange. This clause provides for the system set up relating to all the information necessary for the Stock Exchanges from the company. In order to ensure that India is able to participate in the competitive business around the world effectively, there led to the constitution of the regulatory framework to ensure corporate governance for listed companies. The Code of Corporate Governance published in 1998 by Confederation of Indian Industries (CII) was one of the first codes in Asia.[15]

Corporate governance is governed internally and externally. External factors include the market and the competition. Internal factors majorly include the internal functioning of the company. Internal governance of a company is done by the shareholders and directors. The board of directors are required to ensure that the financial statements of the company are audited. Executive compensation is provided to the members of the board for the purposes of compensation. In countries like the USA, the shareholders do not decide on the compensation amount. However, in India, Kumar Mangalam Birla Committee was constituted in 2000 by the Securities and Exchange Board of India (SEBI) which provided that it is the responsibility of the board of the company to provide for guidance in regard to leadership and strategy, management of the company independent of objective judgement and accountability to the shareholders of the company.[16]

Hence, the Board of Directors of a company has a huge responsibility for which it is required to be updated and acquire all necessary information to take important decisions of the company. In the case of *M.S. Pharmaceuticals Ltd. V. Neeta Bhalla and Anr.*,[17] the three judge bench of the apex court held that the Managing Director or the Joint

14 *Supra* note 8.

15 Sanjay P.S. Dessai, Dr. I Bhanumurthy, *Corporate Governance in India Clause 49 of Listing Agreement,* (Aug. 05, 2020, 10:51 AM), https://www.researchgate.net/publication/228122798_Corporate_Governance_in_India_Clause_49_of_Listing_Agreement.

16 Report of the Kumar Mangalam Birla Committee on Corporate Governance, (Apr. 04, 2020, 12:56 PM), http://www.nfcg.in/UserFiles/kumarmbirla1999.pdf.

17 *M.S. Pharmaceuticals Ltd. V. Neeta Bhalla and Anr.,* (2005) 8 SCC 89.

Managing Director may have different responsibilities in the company; however, they have the responsibility to ensure that the business of the company is conducted effectively. Therefore, in this case, the signatory of the dishonoured cheque is liable under Section 141(2) as the liability of the concerned person office or position in the Company.

Further, in the case of the *Uttar Pradesh Pollution Control Board v Mohan Meakins Ltd.*[18], the Supreme Court opined that any person who holds the office of a Manager or in charge of the conduct of the company is liable under Section 47[19] of Water (Prevention and Control of Pollution) Act, 1974.

## Analysis of Clause 49 and Sarbanes Oxley

Clause 49 of the Listing agreement has been based on the principles of Sarbanes-Oxley Act, 2002 (SOX Act). Sarbanes-Oxley Act, 2002 was ensued for listed companies on US stock exchanges. The SOX Act was passed by the U.S. Congress to aid the investors from fraudulent financial reporting. It broadly covered four areas, corporate responsibility, the increase in criminal punishment, accounting regulation and providing for new protection. The similarities include the number of directors, rules in relation to insider trading, etc. The main difference between Sarbanes-Oxley and SEBI is that under Sarbanes-Oxley, reports of fraud or annihilation lead to 20 years of imprisonment, however, SEBI can initiate criminal proceedings or charge a fine leading to delisting of the company.[20]

The aim of both the legislations is the same, however the structure of SOX Act and Clause 49 are different.

Under Section 404 of the SOX Act, the Management and the auditors establish internal controls for financial reporting ("ICFR")[21]. However, under Clause 49, all aspects to corporate governance are covered and it is not restricted to only financial reporting.

1. Under the SOX Act, the responsibility of internal control lies on the board, which is the certifying authority. However, under Clause 49, Chief Executive Officer (CEO) and Chief Financial Officer (CFO) are the certifying authority[22] for internal controls and are responsible for frauds in the company.

18 *Uttar Pradesh Pollution Control board Vs. Mohan Meakins Ltd.*, (2000) 2 SCALE 532.

19 Offences by companies

20 *Supra* note 10.

21 Sarbanes-Oxley Act, 15 U.S.C., 2002.

22 Securities and Exchange Board of India Act, Listing Agreement, Clause 49, Para V.

2. Under the SOX Act, a committee is established by the board, to ensure financial and accounting reporting. In cases where no such committee is established, directors of the board are considered as member of the audit committee whereby such directors are independent directors. However, the frequency of the meetings is not specified in the SOX Act. Under Clause 49, such details are specified, whereby it is provided that audit committee should consist of at least three directors as members, the audit committee should also consist of Independent Directors constituting two-third members of the committee, and at least one member of the audit committee shall have experience in relation to accounting and management of finance.

3. SOX Act and Clause 49, both require an independent director as a member of the audit committee. However, Independent director is defined differently under both laws. SOX Act defines independent director as a member without consultation fees, whereas Clause 49 defines independent director as:

   - A Director taking only director's remuneration and takes no other monetary benefits.
   - Is not related to any of the management members or the promoters of the Company.
   - Has not been an executive in the previous three years and also did not hold the position of partner in any legal or audit firm of the Company.
   - Does not hold the position of a service provider or supplier to the Company.
   - Holds up to two percent of voting shares of the Company.

4. Under the SOX Act, Section 301 provides for duties of the audit committee in relation to resolution of complaints and process of retaining them. Such complaints maybe of audit, accounts and internal controls[23] of the Company. However, Clause 49 provides for 'Investors Grievance Committee'. Therefore, it may be noted that SOX takes in account the accounting related issues with specificity.

5. Under SOX Act, a code of conduct should be declared and if such code of conduct is not accepted, the reason for the same should be duly mentioned. However, under Clause 49, it is mandatory to publish a code of conduct on the website of the Company. The senior management is required to adhere to such code of conduct. Code of conduct under Clause 49 is also applicable to stakeholders, however under SOX Act, the code of conduct is only applicable to the financial members of the Company.

23 *Supra* note 15, Section 301.

## Case Studies

1. Enron Corporation was one of the biggest companies of America. In 2001, Enron inflated its earnings by 600 million dollars since 1994 by using shell companies and did not disclose its losses in its financial statements. Eventually, Enron had to file for bankruptcy protected in 2002 since its stocks had been reduced to less than $0.75 from $90.75 and the employees lost their savings and the investors of the company lost their equity in the company worth billions of dollars. Enron Corporations was one of the biggest failures of the capital markets in America. This failure was considered to be of the audit committee of the company since it did not have a model of corporate governance to rely on. The audit committee works in accordance with the regulation and SEC which provided for gaps and irregularities in the corporate governance system in the US in early 2000s. The Directors of Enron were paid with the stocks to ensure their interests to be same as the shareholders. This however, led to pressure on the executive members to want higher stock prices using any procedure and prevented the independent directors from questioning the creative accounting process. Further, the audit committee set up Enron was not itself well equipped to accounting practices since it did not hold the knowledge or expertise in accounting practices.

   The Enron scam was due to the inefficiency of the theories of the corporate governance model, the agency theory and the stakeholder theory. The efficient market hypothesis failed since the performance was connected with the compensation, the Board of Directors and the management of the company had close relations and the financial reporting method was ambiguous. Further, it would have been preventive if the stakeholders including supplies and customers were not made part of the management decisions.

2. The Satyam scandal[24], which is also known as 'Enron of India', is considered to be one of the biggest corporate frauds in the country, in which, 94% of the money reflected in the books of the company was shown as the earning of the company, which led to the investor losing around $2.2 billion. In 2015, the Chairman, B. Ramalinga Raju was held liable[25]. The Satyam Computer was established in 1987 and listed on the Bombay Stock Exchange in 1991. These were the few IT companies in the country which recognized the importance of outsourcing in the industry; Satyam Infoway, which was its subsidiary, was the first Indian company from the IT industry to be listed on the NASDAQ.

24 *Chintalapati Srinivasa Raju vs Securities and Exchange Board of India*, AIR 2018 SC 2411.

25 *Satyam Computer Services Ltd.* Before the Securities and Exchange Board of India, 2015 SCC OnLine SEBI 157.

In 2008, the stocks of the Company fell when the acquisition of Maytas was a failure and Satyam Computer Services was forbidden with the World Bank for the next eight years because of charges of data theft and bribery against the Company. Despite the panel of independent directors on its board, the Company faces issues due to lack of an effective corporate governance model. Therefore, Raju was forced to resign from the position of Chairman by accepting the transactions amounting to fraud which were almost of $1 billion (Rs. 7000 crores) and the intention to replace the fictitious assets of its company's with that of Maytas'. The Board of Directors, employees and the auditors (PricewaterhouseCoopers) of the Company were not aware of these activities and intentions for many years. Hence, the Government of India was forced to disband the Satyam board and thereby appointed a competent board of directors.

After the Satyam scandal, the government implemented the Companies Act, 2013 to prevent such frauds in the future. Furthermore, various amendments were initiated in Clause 49 of the Securities and Exchange Board of India (SEBI) to ensure effective market regulation. These amendments led to power with the board of directors and audit committees of the board, requirement of at least one woman director on the board and rotation of the audit company every ten years. However, the major reason behind the issues of corporate scandals lies with lack of effective enforcement and fraudulent practices.

3. The corporate scandal of Wells Fargo & Co. further raised the need of requirement of corporate governance. As the CEO pushed the employees to ensure every customer buy eight products of Wells Fargo, this led to higher pressure on employees who had to meet the requirements by working extra, failure of which would lead to their termination in two months. Hence, the employees started accounts and credit cards for customers without authorization and signatures which creation of over 1.5 million such accounts in a period of 6 years.

   L.A. Times conducted an investigation in 2013 which exposed this scandal and in 2016, Wells Fargo agreed with the regulations in Los Angeles and paid a fine of $185 million. Further it was found that the unethical behaviour of the employees was caused due to the incentive program of the company was against the corporate values. The report suggested that as the Company had fired over 5000 employees for such behaviour, this was no solution to the problem as the issue was the sales goals created by the Company.

## Conclusion

It is observed that the laws like the SOX Act, 2002 and Clause 49 under the Indian legislation are similar in regard to the purpose and function, whereby they aim to protect the stakeholders of the companies. These laws are amended in order to maintain governance on the corporate activities. The Corporate governance featured under the Indian legislation is stringent and also forms part of the Companies Act, 2013; however certain provisions like PCAOB (Public Company Accounting Oversight Board), which is a non-profit corporation created under SOX to ensure effective audit in the company, the PCAOB is not included under clause 49.

Under SOX, PCAOB has the power to ensure audit, inspection and regulate the activities of the auditors or the firms of auditing in the USA. These powers are provided to Indian organisations through the Institute of Chartered Accountants of India (ICAI), whereby it provides for the act of auditing and inspecting the activities of the auditors. However, ICAI does not have the power to make regulations in regard to code of conduct of the auditors. Further, it is observed that certain terms, like internal controls have not been exhaustively defined under the Indian legislation, i.e., Clause 49 and Companies Act, 2013. However, SOX defines internal controls and intends to implement the same with the Committee of Sponsoring Organisations, which is constituted to implement the framework of internal controls in the companies. Such provisions provide a clear and better understanding of the terms and the Committee constitutes the aspect of reliability for the companies. Indian legislation may also begin to provide an unambiguous and reliable meaning of internal controls which would thereby help with the investor's interest and cooperation.

Hence, it may be concluded that by studying the provisions of corporate governance under US laws and Indian laws, the aim and purpose of the provisions are the same in reality. Indian laws, though, have a wider aspect of implementation, however SOX addresses non-compliance and crimes with a stringent view. Therefore, it is essential that amendments are made in order to ensure effective implementation of the Acts owing to the changing times and requirements in the market. This shall ensure that the corporate governance system is strong and reliable.