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NEW CORPORATE GOVERNANCE NORMS

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Corporate governance, which was at one time limited to Clause 49A of the Listing Agreement, has now wriggled its way not only in the Listing Regulations but also prompted markets regulator Securities and Exchange Board of India (SEBI) to impose additional compliance conditions on listed companies.

In March, SEBI accepted most recommendations of the Kotak committee, which had submitted a report to improve governance standards in listed Indian companies.

Listed companies now need to become much more transparent, making many more disclosures than they do now.

The eligibility criteria for independent directors has been made more strict, and the top 500 companies must have at least one woman independent director by April next year, while the top 1,000 companies must have one by April 2020.

SEBI also stated that companies must make detailed disclosures of related-party transactions and that related parties would be permitted to vote against these transactions. Companies will have to make half-yearly disclosures of related-party transactions on a consolidated basis. There will be strict penalties on those failing to do so. Any entity belonging to the promoter group of the listed entity and holding 20% or more of shareholding in the listed entity will be treated as a related party.

SEBI has stated that the positions of the chairman and the CEO or managing directors will be separate for the top 500 listed companies by market capitalisation from April 2020. Moreover, the maximum number of directors on listed companies will be pruned from 10 to eight by April 2019 and further to seven by April 2020.

REASONS FOR SPLITTING TITLES

This may be a welcome change, in as much as there may be a limitation over the board's independence to question the management, if the same person holds both roles of chairman and managing director. The segregation of these powers would bring in a more balanced board structure and effective control over the management.

The separation of powers of the chairperson (leading the board) and the MD/CEO (leading the management) may provide better and more balanced governance structure by enabling more effective supervision of the management.

Several corporate governance codes prescribing best practices across the globe recommend such a bifurcation of roles; a few jurisdictions require it, and many companies are actively debating whether to undertake it despite the lack of a regulatory mandate.

In some jurisdictions, such as the UK and Australia, this debate has tilted in favour of separating the two posts. In other countries, such as France and the US, the issue continues to be vigorously debated. Countries with a two-tier board structure, such as Germany and the Netherlands, separate the top board and top management roles.

In this regard, the Kotak Committee noted the rationale of the UK's Cadbury Committee in a report of the Committee on the Financial Aspects of Corporate Governance (1992) that "given the importance and the particular nature of the chairman's role, it should in-principle be separate from that of the chief executive. If the two roles are combined in one person, it represents a considerable concentration of power".

BOOSTING TRANSPARENCY

SEBI has mandated that independent directors will need to fulfil more criteria to be eligible to sit on boards while audit, nomination, risk management and remuneration committees will play a bigger role. It ruled out a minimum compensation for independent directors but said that the expertise of directors must be spelt out.

In view of this requirement, companies may not be able to appoint individuals related to the promoter group as independent directors or individuals who would not be able to discharge their duties independently due to certain prevailing circumstances or situations.

Indian companies will also have to make disclosures in relation to the credentials and terms of appointment of the auditors. Disclosures on fees paid will prevent companies from paying disproportionately high audit fees in relation to their assets. The move may ensure more transparency and help investors make informed decisions.

DISCLOSURE REQUIREMENTS

A small but welcome change is that companies will now have to submit their consolidated financial statements on a quarterly basis rather than on a yearly basis. SEBI has mandated that there must be more oversight over unlisted 'material' subsidiaries, both in India and overseas. As such, the definition of the term "material subsidiary" may be tightened to include those subsidiaries whose income or net worth exceeds 10% (from the current 20%) of a company's consolidated income or net worth.

In addition, companies must seek majority approval of minority shareholders for payments on account of brand or royalty to a related party exceeding 2% of the consolidated turnover. There are companies in India which make such payments exceeding 2% of their consolidated turnover while some even pay more than 5%. Typically, multinational corporations are known to pay high royalties to their overseas parents. Such payments will now require the blessings of at least half (50% plus one vote) of the minority shareholders.

To add to the compliances, companies must furnish their consolidated accounts every quarter and they must reveal how they have spent the money raised through qualified institutional placements (QIPs) or a preferential issue.

The Kotak Committee observed that, while companies comply with the regulatory minimum, it encourages boards and management to view disclosure and transparency as a means to build trust with stakeholders and to proactively disclose material information that may impact decision-making variables.

SEBI has adopted 40 of the 80 suggestions of the Kotak Committee in totality and 15 suggestions with modifications. SEBI may issue further conditions on listed companies to tighten compliance with corporate governance.

The risks of non-compliance may not only be penalty and fine but may also include delisting from stock exchanges, investors' ire and class-action suits. Indian companies better buck up and comply with these requirements much ahead of the prescribed time.

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