COMPANIES ACT 2013: A TOOL TO STRENGTHEN CORPORATE GOVERNANCE

Ms. Sunita
Assistant Professor, Department of Commerce, Delhi School of Economics, University of Delhi, Delhi.

Abstract
Much awaited Companies Act, 2013 got assent from the president of India on 29th August 2013, however the journey of its enactment has begin in 2004 itself with the efforts of the then government to replace the old ineffective law. The '2013 Act' introduces significant provisions in the area of shareholder democracy, e-governance, compliance and enforcement, disclosure norms, auditors and mergers and acquisitions. It provides for more effective legal regime which is treated to be at par with International standards. Underscoring the importance of Companies Act 2013 in raising the bar on corporate governance, this paper attempts to explain the concept to Companies Act, 2013, development of the new Act and its relevance as a tool to strengthen governance in Indian corporate sector.

Keywords: Companies Act 2013, Corporate Governance, Compliance, Disclosure.

INTRODUCTION

The Companies Act 2013 is landmark legislation and likely to has a positive impact on the corporate sector, health of capital market in India and development of Indian economy. The new '2013 Act' replaces the 57 years old Companies Act, 1956, which was left ineffective to deal with various issues in current scenario. The Companies Act, 2013 got its assent of the president of India on 29th August 2013, however the journey of its enactment has started off in 2004 itself with the efforts of the then government to replace the old ineffective law. Before enactment of the new Companies Act, 2013 it was being introduced as Companies Bill in the Lok Sabha and Rajya Sabha again and again and finally got assent in the Lok Sabha and Rajya Sabha on 18 December 2012 and 8 August 2013 respectively. Enactment of the Companies Act 2013 is an attempt to reduce the content by deleting the redundant provisions as well as introducing the new provisions necessary in the current scenario of India. The recent law has 470 Sections, 7 Schedules and 29 Chapters as compared to more than 750 Sections, 15 Schedules, and 13 parts in the Old Companies Act 1956. However, complete understanding of the implications of the various provisions of the Companies Act, 2013 requires knowledge of the related rules which have been issued by the Ministry of Corporate Affairs from time to time. The 2013 Act introduces significant provisions in the area of corporate governance, e-governance, compliance and enforcement, disclosure norms, auditors and mergers and acquisitions. Some new concepts have also been included in the Companies Act such as one-person company, small companies, dormant company, secretarial audit, rotation of auditors, class action suits, registered valuers, and corporate social responsibility.

REVIEW OF THE LITERATURE

Black and Khanna (2007), aim to check the efforts of corporate governance reforms on the valuation of stock prices. On investigating the effects of May 1999 announcement of major corporate governance reforms sponsored by CII (known as Clause 49) on the share prices Indian firms they concluded that faster growing firms, firms that need external equity capital and cross listed firms gain more than other firms. They put emphasis on the fact that the value of mandatory governance rules differ from country to country and affected by the governance level of that country. Balasubramanian, Black, and Khanna (2008), exemplify firm level governance and its relation with firms' market value with respect to Indian firms. They find that the firm level governance and market value of firms are positively related, which is applicable to both larger and smaller firms. They further suggested that legal requirements in India are sufficiently strict and over-compliance does not result in increase of the firm's value. In the past years a lot of developments in Indian Corporate Laws took place to improve corporate governance but most of the times those were nothing but the transplants of the major developments in the countries like US and UK. In this context, Varottil (2009) explores the adequacy and efficacy of the Indian corporate governance norms or laws and suggested changes like improvement in external audit, reducing the reliance on independent directors, diluting the concept of promoter under law, considering the imposition of fiduciary duties on controlling shareholders and encouraging them for activism to improve the corporate governance of Indian Companies. Since, 1990s India has witnessed a sea change in its corporate governance system. Various reform initiatives have been taken in the corporate governance framework including mandatory and voluntary measures.

Afsharipour (2011) exemplifies the Corporate Governance Reforms in India and divides the reforms in the corporate governance in two phases.

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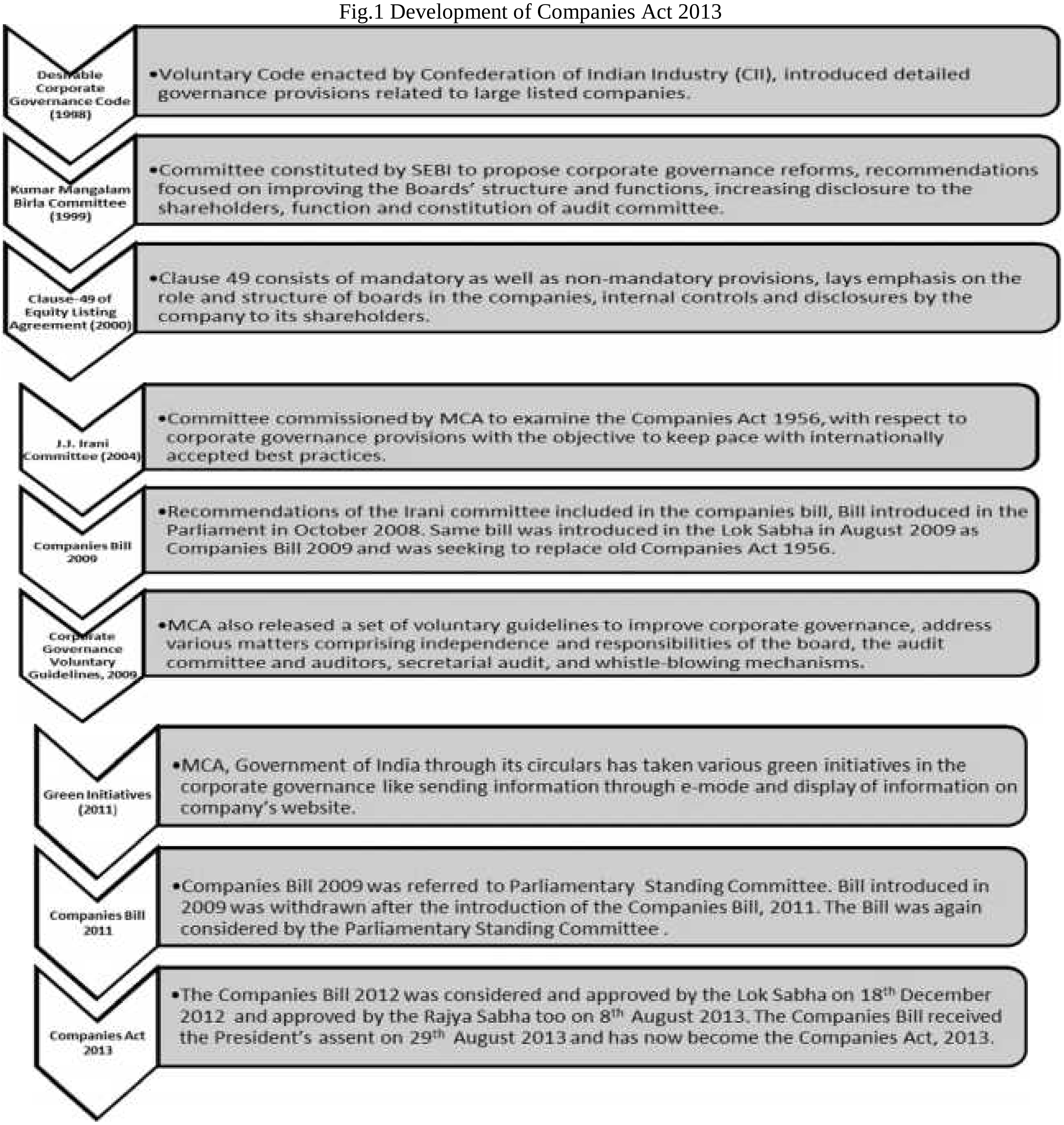
OBJECTIVES OF THE STUDY

- To describe the development of Companies Act 2013.
- To showcase the provisions of Companies Act 2013 relating to corporate governance.
- To examine the new concepts of Companies Act 2013.
- To analyze the relevance of the newly introduced provisions of Companies Act 2013 in context of strengthening corporate governance framework in India.

DEVELOPMENT OF COMPANIES ACT 2013

Fig.1 Development of Companies Act 2013



Corporate governance has been a vital issue in developing countries as well as developed part of the world long before the major corporate scandals occurred in advanced economies as well as corporate scams in India made headlines. In India the word 'corporate governance' was unknown till 1993. However, various positive and negative experiences necessitated recognition of the concept of corporate governance. Development of Companies Act 2013 could be better understood with the help of reforms in the area of corporate governance that took place in India, since 1996. First phase of these reforms took place over the period of 1996 to 2008 and focused on independency of boards and audit committees and giving more powers in the hands of monitors of managements. Whereas second phase of corporate governance reforms followed the SATYAM fiasco, major accounting scandal in 2009 that trembled the Indian corporate sector. Fig. 1 shows a brief overview of the development of the new Companies Act.

COMPANIES ACT, 2013 – NEW CONCEPTS

Companies Act 2013 has been enacted and replaced 57 years old Companies Act 1956. Fig. 1 shows the journey of the enactment of the new Companies Act. This '2013 Act' aims to improve corporate governance in India with its new provisions and changes in the earlier ones. Some new concepts and the concepts related to corporate governance are worth to be discussed here:

- **Key managerial personnel**
  The concept has been defined under Section 2(51) and the scope has been widened. The new Act also provides for mandatory appointment of following whole time key managerial personnel for every listed company and every other company having a paid-up share capital of five crore INR or more:
  (i) Managing director, or chief executive officer or manager and in their absence, a whole-time director.
  (ii) Company secretary.
  (iii) Chief financial officer.
- **Secretarial Audit [Section 204**]
  The 2013 Act provides for a mandatory requirement to have secretarial audit by a Company Secretary in practice, in respect of listed companies and other class of companies as may be prescribed. As per the draft rules, it is applicable to every public company with paid-up share capital > Rs. 100 crores. It is a compliance mechanism to detect the frauds in advance and take corrective measures and thereby aims to improve corporate governance.

- **Serious Fraud Investigation Office (SFIO):** legal status has been given to Serious Fraud Investigation Office.

- **Corporate Social Responsibility**
  Concept of CSR has been included in the new Act as mandatory provision. The Companies Act provides that every company having a net worth of 500 crore INR, or more or a turnover of 1000 crore INR or more, or a net profit of five crore INR or more, during any financial year shall constitute the corporate social responsibility committee and spend at least 2% of the average net-profits of the immediately preceding three years on CSR activities, and if not spent, explanation for the reasons thereof would need to be given in the director's report (Section 135 of the 2013 Act).

- **Insider trading and prohibition on forward dealings**
  With the aim to protect the interest of small investors and public, The 2013 Act introduces for the first time term 'insider trading and price-sensitive information' and prohibits any person including the director or key managerial person from entering into insider trading [section 195 of 2013 Act].

- **Woman director [Section 149(1) of 2013 Act]**
  underscoring the importance of gender diversity, the Companies Act 2013 introduces the concept of requirement of having at least one woman director in respect of (i) Every listed company, and (ii) Every other public company that has paid–up share capital of one hundred crore rupees or more, or a turnover of three hundred crore rupees or more within three years from the commencement of second proviso to sub-section (1) of section 149.

- **Independent directors [Section 149(4) of 2013 Act]**
  The term' Independent Director' has been defined in the Act, along with several rules regarding their appointment, role and responsibilities. The 2013 Act requires every listed public company to have at least one-third of the total number of

directors as independent directors. Under its Section 150, 2013 Act also provides for making the appointment process of these directors independent of the company's management by constituting a panel or a data bank comprising representatives of MCA, SEBI, Reserve Bank of India, professional institutions, Chambers of Commerce and Industry etc. This databank is to be maintained by the MCA, out of which companies may choose their independent directors.

- **Nomination and Remuneration Committee and Stakeholders Relationship Committee**
  Under Section 178 of 2013 Act, every listed company or every other public company that has a paid-up capital of 100 crore INR or more or which has, in aggregate, outstanding loans or borrowings or debentures or deposits exceeding 200 crore INR is required to constitute nomination and remuneration committee. This Committee is required to formulate and recommend to the Board of Directors about company's policies regarding nomination and remuneration. A Company is also required to constitute a Stakeholders Relationship Committee if the board of that company has more than 1000 shareholders, debenture-holders, deposit-holders and any other security holders at any time during a financial year.

- **Related Party Transactions**
  Under Section 188 of 2013 Act, some key changes made in the area of related party transactions include widened ambit of related party transactions, inclusion of transactions with related parties in the board's report. Penalty for contravention of the said provisions are also included in the Act which extends to punishment.

- **Rotation of Auditors**
  With the aim to enhance effectiveness of audit and accountability of the auditors, the '2013 Act' introduces extensive changes in relating to audit and auditors like appointment process of auditors and mandatory rotation of auditors. As per the new provisions the auditor will now be appointed for a period of five years, with a requirement to ratify such an appointment at each annual general meeting. The new law under Section 139 provides for mandatory rotation of auditor every five years in case of individual auditor and every 10 years in case of an audit firm with a uniform cooling off period of five years in both the cases in case of listed companies (and other class(es) of companies as may be prescribed) .The 2013 Act specifies that any service to be rendered by the auditor needs to be approved by the board of directors or the audit committee and the auditor is restricted from providing specific services mentioned under the Act. These restrictions are aimed at achieving auditors' independence and adding credibility to the published financial information and value to investors and as well as the other stakeholders.

- **Registered Valuers**
  The 2013 Act has introduced a new concept of registered valuers who are required for providing valuation reports mandated under provisions of various sections for a fair valuation.

- **Class Action Suits**
  Shareholder democracy is vital in corporate governance. The Companies Act 2013 acknowledges the importance of shareholder democracy by introducing various provisions to protect the shareholders' rights and interest of small shareholders. Class action suits are one of the important concepts to improve the shareholder democracy. Under Section 245 of the Act, a large group of individuals collectively bring a claim to court or in which a particular class of defendants is being sued. By introducing this concept, the new Companies Act 2013 acknowledges the need to be at par with global standards. This has empowered shareholders associations or group of shareholders to take legal action in case of any fraudulent action on the part of company and to take part in investor protection activities and class action suits.

CONCLUSION

The Companies Act, 2013 being a modern legislation enables growth and greater regulation of the Indian corporate sector. Through its better and improved provisions, the new Act facilitates improvement in corporate governance norms, enhancement of the accountability of auditors and companies, increased levels of Transparency and as a result protection of the interest of all stakeholders including shareholders. The 2013 Act also aims to instil self-regulation among the Indian corporate sector and encourage corporate democracy. In most of the areas the Act attempts to align with international requirements. Although, in isolation provisions of companies act do not constitute a paradigm shift but when aggregated, these provisions form a stringent enforcement mechanism that drives a higher level of governance in companies and reduce corruption and fraud. Surely, we can say that Companies Act 2013 is a tool to strengthen corporate governance.

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