THIRD EDITION

Corporate Governance

Principles, Polices and Practices

A. C. Fernando
K. P. Muraleedharan
E. K. Satheesh

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CORPORATE GOVERNANCE

PRINCIPLES, POLICIES AND PRACTICES

Third Edition

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To
Rex and Reshama
for their constant support and encouragement

— A. C. Fernando

Dedicated to our parents

— K. P. Muraleedharan
— E. K. Satheesh

Contents

GOLDEN CASE STUDIES

Abbreviations

AAIFR	–	Appellate Authority for Industrial and Financial Reconstruction
ADB	–	Asian Development Bank
AFL-CI0	–	American Federation of Labor and Congress of Industrial Organisations
AGM	–	Annual General Meeting
AIST	–	Australian Institute of Superannuating Trustees
ALI	–	American Law Institute
AMCs	–	Asset Management Companies
AMFI	–	Association of Mutual Funds of India
AOP	–	Association of Persons
ARF	–	Assets Reconstruction Fund
AS	–	Accounting Standards
ASB	–	Accounting Standards Board
ASC	–	Accounting Standards Committee
ASSOCHAM	–	Associated Chambers of Commerce and Industry
BCCI	–	Bank of Credit and Commerce International
BIFR	–	The Board for Industrial and Financial Reconstruction
BIS	–	Bank of International Settlements
BOL	–	Build–Own–Lease
BOOS	–	Build–Own–Operate System
BOOT	–	Build–Own–Operate Transfer
BOP	–	Balance of Payments
BPE	–	Bureau of Public Enterprises
BSE	–	Bombay Stock Exchange
CAC	–	Capital Account Convertibility
CAD	–	Current Account Deficit
CAG	–	Comptroller and Auditor-general
CAGR	–	Compound Average Growth Rate
CAO	–	Chief Accounts Officer
CARE	–	Credit Analysis and Research Ltd.
CBDT	–	Central Board of Direct Taxes
CBEC	–	Central Board of Excise and Customs
CCFI	–	Cabinet Committee on Foreign Investment
CCI	–	Controller of Capital Issues
CDSL	–	Central Depository Security Ltd
CEO	–	Chief Executive Officer
CFE	–	Certified Fraud Examiner
CFO	–	Chief Financial Officer
CFS	–	Consolidated Financial Statement
CG	–	Corporate Governance
CII	–	Confederation of Indian Industry
CIS	–	Commonwealth of Independent States
CISCO	–	The City Group for Small Companies
CLA	–	Central Listing Authority
CLB	–	Company Law Board

CMD	–	Chairman and Managing Director
CMIE	–	Centre for Monitoring Indian Economy
COFEPOSA	–	Conservation of Foreign Exchange and Prevention of Smuggling Activities
COPU	–	Committee on Public Undertakings
COR	–	Capital–output Ratio
COSO	–	Committee of Sponsoring Organisations
CPA	–	Certified Public Accountant
CPA	–	Consumer Protection Act, 1986
CPI	–	Consumer Price Index
CPSC	–	Consumer Product Safety Commission
CRA	–	Credit Rating Agencies
CRF	–	Consumer Redressal Forum
CRISIL	–	The Credit Rating Information Service of India Ltd.
CRR	–	Cash Reserve Ratio
CSO	–	Central Statistical Organisation
CSR	–	Corporate Social Responsibility
CUTS	–	Consumer Unity and Trust Society
D&OLI Policy	–	Directors and Officers Liability Insurance Policy
DCA	–	Department of Company Affairs, Government of India
DCC	–	Depositories and Custodian Cell (of SEBI)
DEA	–	Department of Economic Affairs
DEMAT	–	Dematerialisation
DGCI&S	–	Directorate General of Commercial Intelligence and Statistics
DICGC	–	Deposit Insurance and Credit Guarantee Corporation
DP	–	Depository Participants
DRI	–	Differential Rate of Interest
DTL	–	Demand and Time Liabilities
EC	–	Executive Chairman
ECB	–	External Commercial Borrowing
ECM	–	European Common Market
ED	–	Executive Director
EDIFAR	–	Electronic Data Filing and Retrieval System (SEBI)
EEC	–	European Economic Community
EEOC	–	Equal Employment Opportunity Commission
EFTA	–	European Free Trade Association
EMR	–	Exclusive Marketing Rights
ESAF	–	Enhanced Structural Adjustment Facility
ESCAP	–	Economic and Social Commission for Asia and the Pacific
ESI	–	Employees State Insurance; Environmental Sustainability Index
ESOP	–	Employee Stock Option Plan
ESOS	–	Employee Stock Option Scheme
ESPS	–	Employee Stock Purchase Scheme
EXIM BANK	–	Export and Import Bank
FRB	–	Federal Reserve Board
FAO	–	Food and Agriculture Organisation
FASB	–	The Financial Accounting Standards Board
FBI	–	Federal Bureau of Investigation
FCCBs	–	Foreign Currency Convertible Bonds
FD	–	Fixed Deposits

FDI	–	Foreign Direct Investment
FEMA	–	Foreign Exchange Management Act
FER	–	Foreign Exchange Reserves
FERA	–	Foreign Exchange Regulation Act
FERC	–	Federal Energy Regulatory Commission
FICCI	–	Federation of Indian Chambers of Commerce and Industry
FIIA	–	Foreign Investment Implementation Authority
FIIs	–	Foreign Institutional Investors
FIPB	–	Foreign Investment Promotion Board
FIPC	–	Foreign Investment Promotion Council
FMCG	–	Fast Moving Consumer Goods
FTC	–	Federal Trade Commission
FTZ	–	Free Trade Zones
GAAP	–	Generally Accepted Accounting Principles
GATT	–	General Agreement on Trade and Tariff
GCA	–	General Currency Area
GCF	–	Gross Capital Formation
GDCF	–	Gross Domestic Capital Formation
GDP	–	Gross Domestic Product
GDRs	–	Global Depository Receipts
GEF	–	Global Environment Fund
GFCF	–	Gross Fixed Capital Formation
GFD	–	Gross Fiscal Deficit
GRT	–	Gross Registered Tonnage
GSTP	–	Global System of Trade Preference
HDI	–	Human Development Index
HPAEs	–	High Performing Asian Economies
IAS	–	International Accounting Standards; Indian Administrative Service
IASB	–	International Accounting Standards Board
IASC	–	International Accounting Standards Committee
IBM	–	International Business Machines
IBPs	–	Inter-bank Participations
IBRD	–	International Bank for Reconstruction and Development (World Bank)
ICAEW	–	The Institute of Chartered Accountants in England and Wales
ICAI	–	The Institute of Chartered Accountants of India
ICC	–	Interstate Commerce Commission
ICICI	–	Industrial Credit and Investment Corporation of India
ICL	–	Indian Confederation of Labour
ICRA	–	The Investment Information and Credit Rating Agency
ICRR	–	Independent Cash Reserve Ratio
ICSI	–	The Institute of Company Secretaries of India
ICWAI	–	The Institute of Costs and Works Accountants of India
IDA	–	International Development Association
IDBI	–	Industrial Development Bank of India
IDI	–	Industrial Development Index
IDRA	–	Industrial Development and Regulation Act
IEBR	–	International Extra Budgetary Resources
IEPC	–	Investor Education and Protection Committee
IEPF	–	Investor Education and Protection Fund

IFAC	–	International Federation of Accountants
IFC	–	Indian Fiscal Commission
IFCI	–	Industrial Finance Corporation of India
IIF	–	Institute of International Finance
IFSA	–	Investment and Financial Services Association
IGG	–	Investors Grievances and Guidance Division, SEBI
IIBI	–	Industrial Investment Bank of India
IIDC	–	Integrated Infrastructure Development Centre
IIM	–	Indian Institute of Management
IIP	–	Index of Industrial Production
ILO	–	International Labour Organisation
IMF	–	International Monetary Fund
IPO	–	Initial Public Offer
IPPs	–	Independent Power Producers
IRDA	–	Insurance Regulation and Development Authority
IRS	–	Internal Revenue Service
IUCN	–	International Union for the Conservation of Nature and Natural Resources
LA	–	Listing Agreement
LATAM	–	Latin America
LERM	–	Liberalised Exchange Rate Mechanism
LIBOR	–	London Inter-bank Borrowing Rate
LLP	–	Limited Liability Partnership
LTFP	–	Long-term Fiscal Policy
MAOCARO	–	Manufacturing and Other Companies (Auditors Report) Order
MAPIN	–	Market Participation and Investor Database (SEBI)
MD	–	Managing Director
MF	–	Mutual Funds
MFA	–	Multi-fiber Agreement
MFN	–	Most Favoured Nations
MIC	–	Monopolies Inquiry Commission
MIS	–	Management Information System
MMMFs	–	Money Market Mutual Funds
MODVAT	–	Modified Value Added Tax
MOF	–	Ministry of Finance
MOU	–	Memorandum of Understanding
MRTP	–	Monopolies and Restrictive Trade Practices
MRTP Act	–	Monopolies and Restrictive Trade Practices Act
MRTPC	–	Monopolies and Restrictive Trade Practices Commission
MSBs	–	Market Stabilisation Bonds
MTN	–	Multilateral Trade Negotiations
MTO	–	Multilateral Trade Organisation
NACD	–	National Association of Corporate Directors
NAFTA	–	North American Free Trade Agreement
NASSCOM	–	National Association of Software and Services Companies (India)
NAV	–	Net Asset Value
NBFCs	–	Non-banking Finance Companies
NCAER	–	National Council of Applied Economic Research
NCDRC	–	National Consumer Disputes Redressal Commission
NCL	–	National Commission on Labour

NCLT	–	National Company Law Tribunal
NDP	–	Net Domestic Product
NEAT	–	National Exchange Automated Trading System
NEF	–	National Equity Fund
NEP	–	New Economic Policy
NFCG	–	National Foundation for Corporate Governance
NGOs	–	Non-government Organisations
NIEs	–	Newly Industrialised Economies
NLRB	–	National Labour Relations Board
NPAs	–	Non-performing Assets
NRIs	–	Non-resident Indians
NRNR	–	Non-resident Non-repatriable Rupee Account
NSDL	–	National Securities Depository Ltd
NSDP	–	Net State Domestic Product
NSE	–	National Stock Exchange
OECD	–	Organisation for Economic Cooperation and Development Organisations
OGL	–	Open General License
OPEC	–	Organisation of Petroleum Exporting Countries
OTCEI	–	Over the Counter Exchange of India
PAC	–	Public Accounts Committee
PBT	–	Profit Before Tax
PCAOB	–	Public Company Accounting Oversight Board
PCDs	–	Partially Convertible Debentures
PCFC	–	Packing in Credit in Foreign Currency
PDS	–	Public Distribution System
PMS	–	Portfolio Management Scheme
POB	–	Public Oversight Board
PPDs	–	Process-cum-product Development Centres
PPPs	–	Purchasing Power Parities
PSEs	–	Public Sector Enterprises
PSU	–	Public Sector Undertakings
QRB	–	Quality Review Board
R&D	–	Research and Development
RBI	–	Reserve Bank of India
RCF	–	Risk Capital Foundation
ROC	–	Registrar of Companies
ROI	–	Return on Investment
SAARC	–	South Asian Association for Regional Cooperation
SADF	–	South Asian Development Fund
SAT	–	Securities Appellate Tribunal
SBI	–	State Bank of India
SCDRC	–	State Consumer Disputes Redressal Commission
SCMRD	–	Society for Capital Market Research and Development
SEBI	–	Securities and Exchange Board of India
SEC	–	Securities and Exchange Commission (USA)
SFC	–	State Financial Corporation
SLR	–	Statutory Liquidity Ratio
SNA	–	System of National Accounts
SOX	–	Sarbanes Oxley Act (USA)

SPC	–	Small Private Company
SRI	–	Socially Responsible Investing
SRO	–	Self-regulatory Organisation
STCI	–	Securities Trading Corporation of India Ltd.
STP	–	Straight Through Processing
TCOs	–	Technical Consultancy Organisations
TDC	–	Technology Development Cell
TDICI	–	Technology Development and Information Company of India Ltd.
TNCs	–	Transnational Corporations
TRIMs	–	Trade Related Investment Measures
TRIPs	–	Trade-related Intellectual Property Rights
UNCTAD	–	United Nations Conference on Trade and Development
UNDP	–	United Nations Development Programme
UNESCO	–	United Nations Educational, Scientific and Cultural Organisation
UNRID	–	United Nations Research Institute for Development
UPS	–	Usual Principal Status
UR	–	Uruguay Round
UTI	–	Unit Trust of India
VAM	–	Value Added by Manufacture
VAT	–	Value Added Tax
VCF	–	Venture Capital Fund
VOICE	–	Voluntary Organisation in Interest of Consumer Education
WDR	–	World Development Report
WHO	–	World Health Organisation
WPI	–	Wholesale Price Index
WTO	–	World Trade Organisation
XGS	–	Exports of Goods and Services
ZBB	–	Zero-base Budgeting

Foreword

When we introduced 'corporate governance' as an elective during my tenure as Director of LIBA, we found the course to be an extremely popular one. The course became popular, partly because of the subject, but largely because of the popularity of Professor Fernando. His book *Corporate Governance: Principles, Policies and Practices* distills and collects the results of all those years of teaching by Professor Fernando at LIBA. I am greatly honoured by the privilege accorded to me by my former colleague in being asked to write the foreword to his book. Today, governance has become a hot subject in every field. We need good governance in government, especially in people-elected governments. In fact, governance is important for effective delivery of the vision of any organisation—NGOs, religious bodies, trade unions, even families.

Corporate governance gains greater importance since it is the largest sector in any country involving most of the human and natural resources and making the largest contribution to the economic development of a country. Unless there is proper corporate governance, no country can progress. Though the importance of corporate governance was always implicit, its relevance came to the fore only after the crisis created by Enron, Andersen and others. Human tendency is to lock the stable after the horses are stolen but, thank God, people awoke to the situation before all the horses were stolen. Today, like the three sisters of a religion—faith, hope and charity—three sisters of corporations—business ethics, corporate governance and social responsibility—are necessary to satisfy all the stakeholders. Everyone speaks about them, most management schools teach them but, alas, very few practise them. At this juncture, it is very timely to have a book on corporate governance from a person who has many years of corporate experience and is an eminent professor of the subject.

The book, starting with the meaning of corporate governance and why it rose to a preeminent position, tackles various issues. Any organisation in a social order has to comply with legal obligations. But this is the minimum one should do. If a corporation fails to comply with the law, the law enforcers will deal a severe blow as they have done to so many corporations. Unfortunately, they catch the culprits very late or after others have caught them, as we often see in movies. But if a corporation believes that it is sufficient to meet the legal requirements alone and aim at maximising profit, it will meet a tragic end sooner than it expects. Today, an organisation has to move beyond legal compliance; it has to have social welfare, quality of life and the country's development at heart. Unless a corporation tries to practise these, it will be swept away by the mighty current of self-interest. If it wants to follow the path of the "invisible hand", its "survival" will be at stake. Professor Fernando, while considering legal compliance, business ethics, corporate governance and social responsibility, also deals with the need for the corporations to have a deep concern for environment. Environmental concern should arise not merely from social responsibility and ethical compliance concerns, but also from the point of view of profitability, growth and ultimately to offer quality of life to its employees and customers. This implies that a corporation, for its very existence, has to be concerned about environment. Professor Fernando deals with all these areas with a large number of examples, in his usual lucid and powerful style. These days, a lot of books are trickling in on these subjects, but very few are comprehensive. I have seen only one, but it is in four volumes. This book will meet the need of management schools, corporations and enforcing authorities.

St Ignatius of Loyola used to speak of his little book *Spiritual Exercises* as a collection of exercises to be practised if one wished to transform oneself. Similarly, this book is a collection of chapters on corporate governance, not just to be read but to be practised. One has to practise it with great sincerity and zeal. It will transform not only the corporate world, but also politics, NGO administration and religious bodies.

N. Casimir Raj, S. J.
Director
XLRI
Jamshedpur

Preface to the Third Edition

We are happy to acknowledge that the second edition of the book *Corporate Governance: Principles, Policies and Practices* has been well received both by academicians as well as students. The book fulfilled a void that existed at that point of time for a well-conceptualized and structured book on the subject of corporate governance, which was then emerging as a new discipline in management science.

Though there were very few institutions that had adopted corporate governance as an elective course, still the demand for the book surged as years went by. More and more libraries and faculty in the department of management started patronising the book.

Thanks to the faculty, students and others who took time to go through the book and also for communicating with us the need to incorporate certain salient features they thought the new edition of the book should have. We are happy to include some of their suggestions.

The Organisation of the Book

The book *Corporate Governance: Principles, Policies and Practices* is divided into four parts with a view to providing instructors and students a convenient and systematic build-up of knowledge on the subject that is being dealt with herein.

Part One: "Understanding of Corporate History and Governance" deals with the basics of corporate governance a student of the subject ought to know such as an overview of the subject, the theory and practice of corporate governance and landmarks in the emergence of corporate governance as a systematised body of knowledge.

Part Two: "Legal Framework and Agents in Corporate Governance" deals with all those agents, institutions and mechanisms that are engaged in promoting corporate governance, and includes the study of shareholders—their rights and privileges; investors' problems and their protection; corporate governance and other stakeholders; the role of board of directors and auditors in ensuring corporate governance and how it is important for commercial banks.

Part Three: This part provides an in-depth study of "Components and Facilitators of Corporate Governance", which deals with all those institutions and role players that are engaged in promoting corporate governance. In this part, students are exposed to the study of business ethics in its relation to corporate governance, corporate social responsibility and environment, besides the role of the media in ensuring corporate governance and how monopoly and competition provide different situations in its implementation in corporations. Part three also deals with such topics as the role of public policies in governing business, the Indian capital market regulator, SEBI and the role of the government in ensuring corporate governance.

Part Four: "Issues and Problems of Corporate Governance in Developed and Emerging Economies" deals with issues and problems of corporate governance in emerging economies such as Russia and India. The last chapter deals with the corporation in a global society.

Features

The book presents a detailed study of corporate governance written in simple and lucid language. Starting with the explanation of the basic issues relating to the subject, it guides the readers from elementary to complex concepts. All theoretical concepts are illustrated with examples from the Indian corporate sector. The book incorporates several features that make it a student-friendly text. Designed to cater to the needs of students both as a text and as a reference volume on corporate governance, the book provides an in-depth coverage of all topics a student ought to know on the subject.

Golden Case Studies: The inclusion of real-world cases for the appropriate chapters presents students with snapshots from the corporate world. These cases have been selected to enable readers understand the multifarious and diverse environment within which Indian corporations operate.

Conclusion: Each chapter includes a conclusion to help students review the key points presented in the chapter.

Notes: Notes provided under each chapter provide not only the explanation for references found in the text, but also the context and a detailed analysis thereof.

Keywords: Keywords highlight the important terms discussed in the chapter.

Discussion Questions: End-of-chapter questions are designed to check the student's comprehension of concepts presented in the chapter.

Suggested Readings: Each chapter includes a list of suggested readings for those who wish to know more about the topics discussed in the chapter from authors who are experts on the subject.

The other features include a Glossary, Useful Web Sites on Corporate Governance and CSR, Official Reports, Prominent Guidelines on Corporate Governance, Links on Corporate Governance and Abbreviations.

The Teaching and Learning Package

The teaching and learning package includes PowerPoint lecture slides, which can be downloaded from the book's companion Web site www.pearsoned.co.in/cg3e

Acknowledgements

I am greatly indebted as the author of this book on corporate governance to all the original thinkers and contributors to the subject. In all humility, I acknowledge with gratitude the contributions of the writers, commentators and committees who elucidated the theoretical and practical aspects of corporate governance, which enabled me to borrow from these writings. I have acknowledged, wherever required, their contributions under notes and references. However, if there are errors or discrepancies in the book, I have no hesitation to accept them as mine and mine alone.

I gratefully acknowledge the help rendered by the following persons in the preparation of this book: Rev. Fr. N. Casimir Raj, S.J., Ph.D., Director, XLRI, Jamshedpur, who provided me an opportunity to handle the course on the subject when he was the director at LIBA and obliged me most willingly by writing the foreword for the book; Rev. Fr. P. Christie, S.J., Ph.D., Director, LIBA, who was most pleased to offer me all facilities to complete my work; M. U. Alagusundaram, who assisted me obligingly in getting my script typed time and again; my students for their help in various ways; Rev. Fr. James Antony for his inputs on the chapter on business ethics; Pradha Narasimhan, who sourced for me all relevant materials on the subject; Prashant Menezes, Sharon Jose, Yashwanti, Edward Paul, Lissle Simcock and Michael, all of whom helped me in numerous ways; and our Librarian, Surya, who went out of her way to get me the books I wanted—which were too many—at the quickest possible time.

I also owe a debt of gratitude to Pearson Education, especially Satish Kumar KVC, who first mooted the idea of the book. Last, but not the least, I owe it to my wife, Mrs Jossie C. Fernando who had to lead a lonely life for almost two years as I was immersed during all my waking hours in writing, proof-reading, editing and reshuffling the chapters of the book.

A. C. Fernando

We acknowledge the support and encouragement given by former professors of Department of Commerce and Management Studies Prof. K. C. Vijayakumar, Prof. T. Govindankutty Nair and Prof. E. P. Sainul Abideen. We also acknowledge the contribution and support given by all the teachers, students, non teaching staff and librarian of the Department of Commerce and Management Studies, University of Calicut for the timely completion of the work.

Eventually, I spotlight my record of appreciation for the unstinted and incomparable support provided by my friends in Pearson Education for carving this book, Pradeep Kumar Bhattacharjee and M. Balakrishnan.

K. P. Muraleedharan
E. K. Satheesh

Preface

It gives me great pleasure to place *Corporate Governance: Principles, Policies and Practices* in the hands of teachers, students and other interested readers. As a college teacher of economics, I developed an interest in India's industrial growth and all connected issues. After almost two decades as a professor, I moved to industry and was able to observe, at close quarters, how companies were run and how often they were misgoverned.

This exposure to developments in the corporate world prompted me to pen a well-received article "Corporate Governance—The Time for a Metamorphosis" in *The Hindu* in July 1997. Corporate governance was, at this time, gaining currency among stakeholders. When I returned to academics soon thereafter, I got an opportunity to teach a course on corporate governance at the Loyola Institute of Business Administration (LIBA). I realised then that though there were many books on the subject, almost all of them dealt with specific areas, like the role of directors or compensation for managers. There was not a single book that catered to the all-inclusive needs of postgraduate commerce, economics or management students in an elective (3-4 credit) course on corporate governance (an increasingly popular option). My students encouraged me to write a book that would contain in one volume all the material they would normally have to collect from diverse sources.

Having realised the need for a comprehensive book on corporate governance for not only students, but also researchers, scholars of issues relating to company management, and general readers, I have attempted to provide an in-depth analysis of the subject in a single volume. This text covers the emergence of the concept of corporate governance, the manner in which it was crystallised into a subject of significance, its various problems and issues, its constituents, and how it is being implemented, both in India and abroad.

This book also presents a comparative study of how various countries approach the concept, how they have institutionalised mechanisms for governance, and where they are headed. It addresses multi-dimensional perspectives—of shareholders and other stakeholders like employees, regulators, environmentalists, creditors, the government, and society at large.

The text has been written with the beginner and general reader in mind. Simple, yet lucid, language is used to explain concepts and theories, and illustrations are provided wherever necessary. For those not familiar with economic, commercial, and corporate jargon, a glossary of terms is provided at the end of the book. Likewise, a list of acronyms and their expansions is also provided.

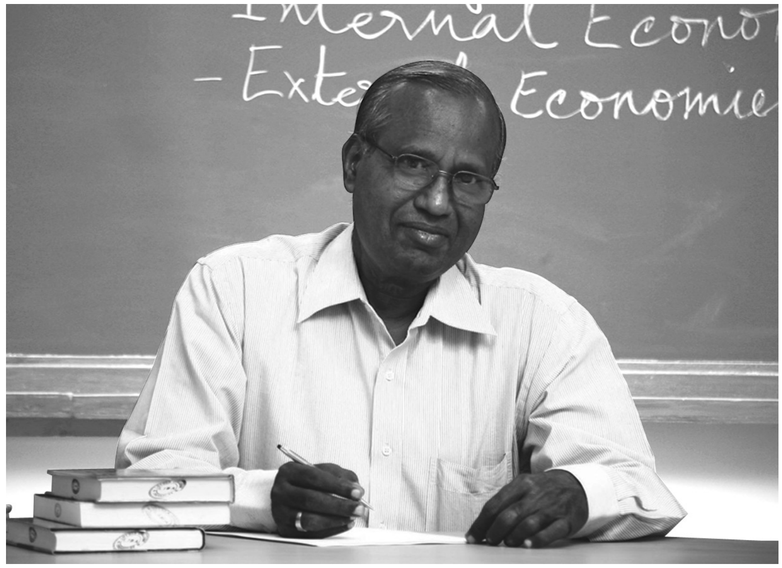
For researchers and advanced learners too, this book provides ample material. An exhaustive reference of books, magazines and journals on the subject is included to facilitate research. Likewise, a long list of Web sites, containing a wealth of material, has been added along with guidelines on corporate governance and quick links to what has been done by governments, international organisations, NGOs and industry federations.

This book is written in a way that would be highly helpful for those who teach the subject. It offers comprehensive coverage of the subject, while never overstressing or elaborating the trivial. Fifteen case studies, appended to appropriate chapters, will enable professors to guide their students effectively.

I am fully aware that this book will serve its purpose only if it fulfils every need of students, teachers and other readers. While I request their indulgence for any error or flaw found in the book, I also solicit their opinions, reviews, comments and suggestions to improve the successive editions of the book.

A. C. Fernando

About the Author



Late A. C. Fernando has just retired as a senior professor of Economics and Corporate Governance at the Loyola Institute of Business Administration (LIBA), Loyola College, Chennai. He was then the Director of the Loyola Centre for Business Ethics and Corporate Governance, a centre of excellence established by LIBA. He has been teaching economics-related subjects and Corporate Governance at LIBA since 1990. He was also the Editor of *Management Matters*, a bi-annual business journal of the institution.

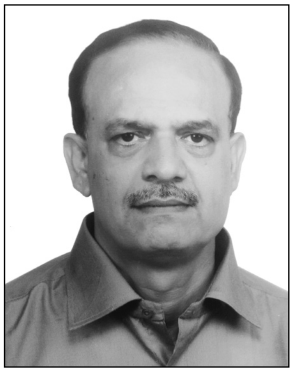
Professor Fernando obtained a postgraduate degree in economics from the University of Madras, following which he was appointed a lecturer in the Department of Economics, Sophia College, Bombay, where he taught all courses relating to economics for 15 years. He was also associated with the University of Bombay where he taught Public Finance for a couple of years at the postgraduate level and pursued research. Concurrently, he also conducted a socio-economic survey on Catholic orphanages for Miserior and worked as a consultant in industry.

Subsequently, Professor Fernando moved to Chennai as the Director of the Training Division of Datamatics Corporation, Chennai, where he designed and conducted several short-term non-formal management and other inter-disciplinary programmes. Having spent a decade as a non-formal educational administrator, he joined a large Chennai-based industrial conglomerate as Corporate Manager, Publicity and Public Relations and Editor of their world-renowned industrial directory, a position he held for almost ten years. During this time, he continued to teach management courses as visiting faculty at the University of Madras, the Institute of Chartered Accountants of India, the Institute of Company Secretaries of India, the Institute of Bankers and LIBA.

He has co-authored six books on economics, edited three issues of a prestigious industrial directory, Kothari's Industrial Directory of India, apart from several issues of *Management Matters*, authored articles on education, economics, management and corporate governance, which have been published by frontline publications including *The Hindu*. His latest books—*Business Ethics* and *Corporate Ethics, Governance and Social Responsibility*—have been well-received by instructors and students in institutes and universities across the country.

A communicator par excellence, Professor Fernando's expertise in corporate governance stems from his 50-year long teaching experience of the subject as well as his incisive knowledge of the functioning of the Indian economy.

About the Contributors



K. P. Muraleedharan was the former Director and Dean of School Business Studies, University of Calicut and also Head of the Department of Commerce and Management Studies. He was born and raised in Feroke, a small town in the district of Calicut, Kerala. Dr K. P. Muraleedharan owns an impeccable academic career by completing his under-graduation and post-graduation in the department of Commerce from Farook College affiliated under the University of Calicut. With a stint of academic excellence, he also pursued his MBA from Bharathiar University and was honoured with Ph.D. in Marketing from the University of Calicut. Dr K. P. Muraleedharan has been teaching Marketing and Finance for the past 36 years.

Dr Muraleedharan has been associated with multiple institutions throughout his teaching career for a succinct period of time. He kickstarted his professional teaching career from several NSS Colleges in Kerala and contributed his extensive academic knowledge to the Department of Commerce at the University of Kerala and the University of Calicut till his tenure as a professor in 2017. He also served as a professor in Marketing for a brief period in the Modern College of Business and Science, Sultanate of Oman.

For acquitting himself well in the teaching profession, Dr Muraleedharan have successfully guided 18 students for Ph.D. and 45 students for M.Phil. so far. He has also published more than 45 research papers in both national and international journals. His major areas of interest in research includes Marketing, Corporate Governance, Investment Management and other Finance related domains.

Dr Muraleedharan served as a Dean for the Faculty of Commerce at the University of Kerala for two terms and was acquainted as a Dean for the Faculty of Commerce and Management Studies at the University of Calicut for three terms. Apart from his professional service as the Coordinator of MBA and MHA programs at the School of Management Studies, Aranattukara, Trichur for the past 16 years, Dr Muraleedharan has served as the member of the Academic Council of the University of Kerala and the University of Calicut for 12 years. He also served as the Director for the College Development Council at the University of Calicut and a functional Member, Syndicate at Sree Sankaracharya Sanskrit University, Kalady for three years.

Dr Muraleedharan is recognized with a membership in various professional bodies like the Indian Commerce Association, the Indian Accounting Association, the Trichur Management Association and various expert committees of different universities, UGC and AICTE.

E. K. Satheesh is a Professor of Financial Management in the Department of Commerce and Management Studies. He is currently the Dean for the Faculty of Commerce and Management and former Head, Department of Commerce and Management Studies, University of Calicut. E. K. Satheesh completed his M.Com. degree from the Department of Commerce and Management Studies. He was also honoured with an endowment award for best performance in M.Com. and MBA degree courses from Pondicherry University. With a subtle academic performance, Satheesh received his Ph.D. in Merchant Banking and Financial Services from the Department of Commerce and Management Studies, University of Calicut associated with a fellowship from the University Grants Commission. Since 1995, he has held various academic and administrative positions in NSS College and University of Calicut. Satheesh has contributed his knowledge by providing guidance to 2 Ph.D. and 10 M.Phil. students for preparing dissertations. He is also a life member of Indian Institute of Public Administration, New Delhi. Notably, E. K. Satheesh has published more than 25 research papers in reputed journals and played a major role as a resource person and key note speaker. His papers have been presented in more than 50 national and international conferences, seminars, workshops, symposiums throughout India. For having completed his one minor project and one major project from the University Grants Commission, in November 2017, he received an invitation from the British High Commission for academic collaboration. Owing to his remarkable academic career, Satheesh was also invited to UAE to address the postgraduate students.

PART ONE

Understanding of Corporate History and Governance

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Corporate History, Structure and Ownership Pattern

CHAPTER OUTLINE

- Introduction
- Characteristics of a Company
- Types of Company
- History of Modern Corporate Form of Business
- History of Company Form of Business in India
- Cotton Boom and Jute Boom and Formation of Stock Exchanges in India
- Growth of Public Sector Companies
- SEBI
- Disinvestment Policy of Government of India
- Corporate Structure in India
- Corporate Ownership Pattern
- Corporate Ownership in Different Countries
- Shareholding Categories

Introduction

The discussion on corporate governance is as old as the history of company form of business model. The English word 'Company' has originated from the French word '*Compaignie*' which means a body of soldiers. In strict sense a company is an association of person formed for the purpose of achieving some common objectives. In other words a **Company** is a legal entity made up of an association of persons, be it natural, legal, or a mixture of both, for carrying on a commercial or industrial enterprise. Company members share a common purpose and unite in order to focus their various talents and organize their collectively available skills or resources to achieve specific, declared goals. Companies take various forms such as:

According to Marshall, "A company is a artificial person, invisible, intangible and existing only in the contemplation of law".

It is a incorporate association—artificial person-perpetual succession—common seal—transferability of share—limited liability-separation of ownership and management.

- Voluntary associations organised in public and private sector which may include any non-profit organisation.
- A group of soldiers organised to accomplish a task.
- Business entities with an aim of gaining profit.
- Financial entities and banks.

A more broad definition of company is that it is an artificial person created by law, having perpetual succession and common seal, who can sue and be sued on it.

According to the US law a company may be a "Corporation, partnership, association, Joint Stock Company, trust, fund or organised group of persons whether incorporated or not including any receiver, trustee in bankruptcy or similar official or liquidating agent for any of the for going". In the US a company need not necessarily be a corporation. As per the British law a company is a body corporate or a corporate company registered under the British Company Act or similar legislation. The common establishments of company in Britain include private company limited by guarantee, companies without share capital, private company limited by shares and public limited company.

As per the Indian Companies Act a company is "One formed or registered under the Indian Companies Act 2013 or an existing company". An existing company is a company formed or registered under any of the previous company laws. This definition does not reveal the distinctive characteristics of a company. According to Marshall, "A company is a person artificial, invisible, intangible and existing only in the contemplation of law. It possesses only those properties which the character of its creator confers up on it either expressly or as incidental to its very existence".

Another comprehensive and clear definition of a company is given by Lord Justice Lindley, "A company means an association of many persons who contribute money or money's worth to a common stock and employs it in some trade or business, and who share the profit and loss (as the case may be) arising there from. The common stock contributed is denoted in money as the capital of the company. The persons who contribute it, or to whom it belongs are members. The proportion of capital to which each member is entitled is his share. Shares are always transferable although the right to transfer them is often more or less restricted". According to Haney, "A Joint Stock Company is a voluntary association of individuals for profit, having a capital divided into transferable shares. The ownership of which is the condition of membership".

From the above definitions, it can be concluded that a company is a registered association which is an artificial legal person, having an independent legal entity with a perpetual succession, a common seal for its signatures, a common capital comprising transferable shares and carrying limited liability.

Characteristics of a Company

The main characteristics of a company are:

1. **It is an incorporated association.** A company is created when it is registered under the Companies Act. It comes into being from the date mentioned in the certificate of incorporation. For establishing a public company at least seven persons and for a private company at least two persons are required. These persons will subscribe their names to the Memorandum of Association and also comply with other legal requirements of the Act in respect of registration to form and incorporate a company, with or without limited liability.
2. **Artificial legal person.** A company is an artificial person. Negatively speaking, it is not a natural person. It exists in the eyes of the law and cannot act on its own. It has to act through a board of directors elected by the shareholders. But for many purposes, a company is a legal person like a natural person. It has the right to acquire and dispose of the property, to enter into contract with third parties in its own name, which can sue and be sued in its own name. However, it is not a citizen as it cannot enjoy the rights under the Constitution. The company does not become a citizen of India.
3. **Separate legal entity:** A company has a legal distinct entity and is independent of its members. The creditors of the company can recover their money only from the company and the property of the company. They cannot sue individual members. Similarly, the company is not in any way liable for the individual debts of its members. The property of the company is to be used for the benefit of the company and not for the personal benefit of the shareholders. On the same grounds, a member cannot claim any ownership rights in the assets of the company either individually or jointly during the existence of the company or on its winding up. At the same time the members of the company can enter into contracts with the company in the same manner as any other individual can.
4. **Perpetual succession:** A company is a stable form of business organisation. Its life does not depend upon the death, insolvency or retirement of any or all shareholder(s) or director (s). Law creates it and law alone can dissolve it. Members may come and go but the company can go on forever.
5. **Common seal.** As pointed out earlier, a company being an artificial person has no body similar to natural persons and as such it cannot sign documents for itself. It acts through natural persons who are called its directors. But having a legal personality, it can be bound by only those documents which bear its signature. Therefore, the law has provided for the use of common seal, with the name of the company engraved on it, as a substitute for its signature. Any document bearing the common seal of the company will be legally binding on the company.
6. **Limited liability:** One of the most distinguishing characteristics is the limited liability. A company form differs from a sole trader or partnership form model of business mainly because of these characteristics. A company may be limited by shares or limited by guarantee. In company limited by shares, the liability of members is limited to the unpaid value of the shares.
7. **Transferable shares.** In a public company, the shares are freely transferable. The right to transfer shares is a statutory right and it cannot be taken away by a provision in the articles. However, the articles shall prescribe the manner in which such transfer of shares will be made and it may also contain bona fide and reasonable restrictions on the right of members to transfer their shares. But absolute restrictions on the rights of members to transfer their shares shall be ultra vires. However, in the case of a private company, the articles shall restrict the right of member to transfer their shares in companies with its statutory definition.

8. **Separate property:** As a company is a legal person distinct from its members, it is capable of owning, enjoying and disposing of property in its own name. Although its capital and assets are contributed by its shareholders, they are not the private and joint owners of its property. The company is the real person in which all its property is vested and by which it is controlled, managed and disposed of.
9. **Separation of ownership and management:** A joint stock company is an autonomous, self-governing and self-controlling organisation. Since it has a large number of members, all of them cannot take part in the management of the affairs of the company. Actual control and management is, therefore, delegated by the shareholders to their elected representatives, known as directors. They look after the day-to-day chores of the company. This characteristic gives a peculiar relationship between the shareholders and the Board of directors called 'Agent- Principle relations' or 'Shareholders theory' which is the main focus of the discussion on corporate governance.

Types of Company

Joint Stock Company can be of various types. The following are the important types of company.

Classification of Companies by Mode of Incorporation

Depending on the mode of incorporation, there are three classes of joint stock companies:

1. **Chartered companies:** These are incorporated under a special charter of the King or Queen. The East India Company and The Bank of England are examples of chartered companies incorporated in England. The powers and nature of business of a chartered company are defined by the charter which incorporates it. A chartered company has wide powers. It can deal with its property and bind itself to any contracts that any ordinary person can. In case the company deviates from its business as prescribed by the charter, the Sovereign can annul the latter and close the company. Such companies do not exist in India.
2. **Statutory companies:** The companies which are incorporated by a Special Acts of parliament or state legislature are called statutory company. Reserve Bank of India, State Bank of India, Industrial Finance Corporation, Unit Trust of India, State Trading Corporation and Life Insurance Corporation are some of the examples of statutory companies. Such companies do not have any memorandum or articles of association. They derive their powers from the acts constituting them and enjoy certain powers that companies incorporated under the Companies Act. Alterations in the powers of such companies can be brought about by legislative amendments.
3. **Registered companies:** These are formed under the Companies Act, 2013 or under the Companies Act passed prior to this. Such companies come into existence only when they are registered under the Act and a certificate of incorporation has been issued by the Registrar of Companies. This is the most popular mode of incorporating a company. Registered companies may further be divided into three categories namely:
   (a) Companies limited by shares: These types of companies have a share capital and the liability of each member or the company is limited by the Memorandum to the extent of face value of share subscribed by him. In other

words, during the existence of the company or in the event of winding up, a member can be called upon to pay the amount remaining unpaid on the shares subscribed by him. Such a company is called the company limited by shares. A company limited by shares may be a public company or a private company. These are the most popular types of companies.

(b) **Companies limited by guarantee:** These types of companies may or may not have a share capital. Each member promises to pay a fixed sum of money specified in the memorandum in the event of liquidation of the company for payment of the debts and liabilities of the company This amount promised by him is called 'Guarantee'. The articles of association of the company state the number of member with which the company is to be registered. Such a company is called a company limited by guarantee. The amount of guarantee of each member is in the nature of reserve capital. This amount cannot be called upon except in the event of winding up of a company.

(c) **Unlimited companies:** A company not having any limit on the liability of its members is called an 'unlimited company'. The liability of each member extends to the whole amount of the company's debt and liabilities. It is more or less similar to a partnership form of entity except the fact that third party cannot sue the members of the company directly as in the case of partnership because of the separate legal entity status. Thus the creditors shall have to institute the proceedings for winding up of the company for their claims. The official liquidator may be called up on the members to discharge the debts and liabilities without limit. An unlimited company may or may not have a share capital. If it has a share capital it may be a public company or a private company. If the company has a share capital, the article shall state the amount of share capital with which the company is to be registered.

On the Basis of Number of Members

On the basis of number of members, a company may be:

1. Private Company
2. Public Company

Private Company

The term Private Company has been defined under section 2(68) of the Indian Companies Act 2013. According to it a private Company means a company, which has a minimum paid up share capital of ₹1,00,000 and which provides the following restrictions through its Articles of Association and Memorandum:

> According to section 2(68) of the Indian Companies Act 2013, a private company means a company having a minimum paid up capital of ₹1 lakh, and its article restricts transfer of shares, maximum number of members to 50, prohibits invitation to public to subscribe shares or debentures, etc.

- Restricts the transfer of shares by its members.
- Limits the maximum number of members to 50.
- Prohibits any invitation to public for debentures of the company. It also enjoys special privilege's, such as:
  - It can be started with only two members,
  - It is not required to issue a prospectus and
  - It can start its operations immediately after receiving the Certificate of Incorporation.

Public Company

According to Indian Companies Act 2013 'A public company is not a private company'. If we explain the definition of Indian Companies Act in regard to the public company, we note the following:

1. The articles do not restrict the transfer of shares of the company.
2. It imposes no restriction on the maximum number of the members on the company.
3. It invites the general public to purchase the shares and debentures of the companies.
   (a) **Minimum number:** The minimum number of persons required to form a public company is seven.
   (b) **Maximum number:** There is no restriction on maximum number of members in a public company, whereas the maximum number cannot exceed 50 in a private company.
   (c) **Public subscription:** A public company can invite the public to purchase its shares or debentures.
   (d) **Issue of prospectus:** Unlike a public company a private company is not expected to issue a prospectus or file a statement in lieu of prospectus with the Registrar before allotting the shares.
   (e) **Transferability of shares.** In a public company, the shares are freely transferable.

On the Basis of Control

Public company is a company defined as a company which is not a private company

On the basis of control, a company may be classified into

1. Holding companies
2. Subsidiary company

Holding Company

A company is known as the holding company of another company if it has control over the other company. A company is deemed to be the holding company of another if, but only if, the other is its subsidiary. A company may become a holding company of another company in either of the following three ways:

(a) by holding more than fifty per cent of the normal value of issued equity capital of the company; or
(b) by holding more than fifty per cent of its voting rights; or
(c) by securing to itself the right to appoint, the majority of the directors of the other company, directly or indirectly. The other company in such a case is known as a 'Subsidiary company'. Though the two companies remain separate legal entities, yet the affairs of both the companies are managed and controlled by the holding company. A holding company may have any number of subsidiaries. The annual accounts of the holding company are required to disclose full information about the subsidiaries.

Subsidiary Company

A company is known as a subsidiary of another company when its control is exercised by the latter (called holding company) over the former called a subsidiary company. Where a company (company S) is subsidiary of another company (say Company H), the former (company S) becomes the subsidiary of the controlling company (company H).

On the Basis of Ownership of Companies

(a) **Government companies:** A Company of which not less than 51 per cent of the paid up capital is held by the Central government or by the State government singly or jointly is known as a government company. It includes a company subsidiary to a government company.

The share capital of a government company may be wholly or partly owned by the government, but it would not make it the agent of the government.

(b) **Non-government companies.** All other companies, except the government companies are called non-government companies. They do not satisfy the characteristics of a government company as given above.

On the Basis of Nationality of the Company

(a) **Indian companies:** These companies are registered in India under the Companies Act, 1956 and have their registered office in India. Nationality of the members in their case is immaterial.

(b) **Foreign companies:** It means any company incorporated outside India which has an established place of business in India. A company has an established place of business in India if it has a specified place at which it carries on business such as an office, store house or other premises with some visible indication of premises.

Forms of Business Organisation

Right from the beginning of the economic history of mankind to date, the business is carried out in four different forms namely sole proprietorship form, partnership form, corporate form and cooperative form.

Forms of Business
Proprietary firms—partnership firms—company form and cooperative organisation.

Proprietary Form of Business

The earliest and mostly widely used model of business all over the world is the sole proprietorship or proprietary business. As the name indicates it is one man business. The proprietor or sole trader generates business idea; contributes capital and takes complete risk of running the business. He also takes the whole profit. He is personally liable for the whole obligations of the business. Not only are his business properties liable for the obligation of the business but also his private properties. The ownership and control also rests with the same individual. There is no separation of ownership and management. There is no distinction between business and business man. Hence the business ceases to exist at the death of the proprietor. This mode of business is used when the amount of capital required is less, business risk is low and scale of operation is not large.

Partnership Form

When the scale of operation is increased, more capital is required and risk level increases, the business assumes partnership form with two or more business men joining together and conduct the business. According to section 4 of the Indian