Corporate Governance and Business Responsibility

An Empirical Assessment of Large Indian Companies

Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH

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Foreword IICA

The Ministry of Corporate Affairs released the National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business (NVGs) in 2011 to encourage businesses to adopt Business Responsibility as part of core business. Backing the efforts of the Ministry, the Securities and Exchange Board of India in August 2013 mandated the top 100 listed companies (by market capitalization) to submit Business Responsibility Reports based on the NVGs as part of their Annual report. Policy initiatives and regulatory measures like these provide a framework of action for businesses to enhance their competiveness and development impact.

The recently passed Companies Act 2013 is another nudge to the companies in this direction. The new legislation introduces policy reforms aimed at improving governance norms, enhancing transparency and disclosures, increasing accountability at the Board and top management level, protecting the interest of investors particularly small and minority investors. The Act resonates with the overall philosophy of the NVGs that places Responsible Corporate Governance (RCG) at the core of Business Responsibility (BR).

As the principal think tank for the MCA and the nodal agency on all matters related to corporate functioning, IICA plays a facilitating role in steering these policy initiatives and is supported by the IICA-GIZ Business Responsibility Initiative, the bilateral co-operation Project between Indian Institute of Corporate Affairs and the Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH in its endeavours. The study "Corporate Governance and Business Responsibility: An Empirical Assessment of Large Indian Companies" is the first empirical analysis of compliance and beyond compliance performance of companies that sheds light on the intricate drivers and barriers towards the understanding and practice of responsible corporate governance.

I congratulate GIZ and gTrade for undertaking this important piece of research. Research and dialogue form the basis of creating consensus on ideas and consequent action, and IICA is committed to taking stakeholders along in this journey.

With best wishes

Dr. Bhaskar Chatterjee
Director General & CEO, IICA

Foreword GIZ

The practice of Business Responsibility (NVGs) which has the integrated understanding of sustainability - social, environmental and economic - as the core driver of business strategy requires a fillip from the company, the market and the state. In India, the State has shown the direction with its policy initiatives and regulations. But, these measures are only as good as their adoption.

Direct engagement of Boards of companies, their governance structures and processes need to evolve into considering the risks and opportunities companies face through the lens of sustainability and be transparent to their stakeholders about how they manage them. This expanded notion of corporate governance is what is purported to be explored, refined and fostered through research and dialogue amongst diverse stakeholders.

The study in your hands is the first empirical assessment of large companies on how they fare on compliance and how, if at all, they go beyond compliance. It also explores how barriers and enablers in the market play out and how they are affected positively or negatively by measures that the State takes.

GIZ and the Indian Institute of Corporate Affairs, through their bilateral cooperation project since 2008, are engaged closely with businesses, civil society and government agencies in stepping up the discourse on business responsibility and it's widespread adoption. Fostering responsible corporate governance is the next logical step in this direction and also in line with the impulse of the time.

GIZ congratulates gTrade for having executed this seminal work with commendable passion and rigour. We also thank all stakeholders who came forward and engaged actively to validate the assessment. We hope that next steps towards creating a framework of action on responsible corporate governance will be informed by this piece of research and a wider dialogue will be pursued.

With best wishes

Manfred Haebig
Director
Private Sector Development
GIZ India

Foreword gTrade

It is widely accepted today that the onus for business responsibility must lie with senior management and Board members of corporations. The contours of what constitutes 'responsibility' though are still under discussion and description. However, there is a broad consensus that this must imply integration of environmental, social and economic priorities within the business model and governance processes of companies.

The Board of Directors of any firm have a significant role to play in terms of providing strategic vision as well as performing critical oversight of business operations. Therefore any efforts at embedding sustainability within business operations, whether through mandatory or prescriptive frameworks, must originate at the level of the Board.

Additionally, the entire market ecosystem within which firms operate is also relevant to the business responsibility discourse. For instance, the performance metrics of production supply chains are often overlooked by companies. Even within large companies, oversight of supply chains, are limited to negotiations on price points and timelines. This must see radical transformation. Similarly, long term risk assessment frameworks around environment, social responsibility and good governance practices must become a part of decision making processes at the highest levels.

Lack of awareness at the level of the Board is not the only impediment to holistic integration of sustainability priorities in the case of large Indian companies. For enhanced community engagement to become a pillar of business operations, systemic policy hurdles need to be addressed (for example: inefficient licensing regimes in critical sectors).

In India, like in most other places, corporate governance and business responsibility tend to be viewed as being mutually distinct. However, this study shows that there is visible correlation between adherence to corporate governance regulations and business responsibility norms – which is precisely the paradigm of 'responsible corporate governance' that is referred to in this research report.

This study establishes that large companies that already have the basic mandatory processes and governance structures in place are more likely to also be the ones that tend to adhere to voluntary norms. Therefore, further analysis and research is required to study behavioural drivers at the level of the Board as well as the impacts of regulatory processes across and within sectors. On the external front, sustained effort is required by stakeholders to bridge institutional capacity gaps, in order to streamline and harmonise regulatory processes and policies with 'intra-company' mechanisms.

So clearly, two sets of core issues need to be addressed. The first, dealing with internal corporate processes; and the second related to the interaction of these with the regulatory environment and societal expectations. This study is the first step in analysing some of the above and beginning an engagement with multiple stakeholders to discover next steps and pragmatic pathways that would allow accelerated adoption of best in class responsible corporate governance practices by all and certainly by the large corporations that have a compelling impact on society, environment and development.

I would like to thank the Indian Institute for Corporate Affairs (IICA) and the Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH, for their continued support and guidance in the conceptualisation, and writing of this report. And, I would like to congratulate Vivan Sharan and Andrea Deisenrieder for their stellar work and very interesting research on one of the most debated themes of these times.

Samir Saran
Chairman and CEO, gTrade

Acknowledgements

gTrade works on sustainability issues with the government and the private sector. gTrade will like to express its gratitude to Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) for its support and a very fruitful engagement on this research project. Our special thanks go to Manfred Haebig, Director Private Sector Development; Ms. Neha Kumar, Senior Technical Expert; and Nandini Sharma, Project Advisor, GIZ India for their unflinching guidance and adding value in conceptualising the study, and helping it to achieve its current shape and form.

We thank the Indian Institute for Corporate Affairs for their continued engagement during the entire period of developing the study. The study is enriched by the inputs received from multiple stakeholders, who participated in the consultations and made their time for personal interviews within tight time constraints. We deeply value their contribution. A special thanks to Manoj Arora, Additional Director, Ministry of Finance for his constant support and strategic inputs into the study.

We hope the study will trigger discussion, dialogue and action among relevant stakeholders and help take the next steps that promote the practice of responsible corporate governance – an essential ingredient of responsible business behavior.

Acknowledgements

Executive Summary

Through objective and qualitative analysis, this study attempts to show that corporate governance and business responsibility are the twin pillars of 'responsible corporate governance'. The notion of responsible corporate governance is precisely what it communicates - to govern corporations responsibly. Therefore a commensurate onus lies with senior management and Board members. In India, as in most other places around the world, corporate governance and business responsibility tend to be viewed as being mutually distinct. This study suggests that the correlation between adherence to corporate governance regulations and business responsibility norms is positive; and the sum of both lead to responsible corporate governance.

The study looks at two sets of large companies operating in the Indian markets. The first is large listed companies (SENSEX constituents) and the second is large unlisted companies. Large listed companies are subject to additional regulations, given that they are accountable to public shareholders. Large companies are also subject to a slew of voluntary governance norms – which become part of what is termed in this report as 'beyond compliance'. That is, companies which adhere to voluntary norms go beyond the enforced regulatory mandate.

The second set is large unlisted companies. Almost all unlisted companies in India are family owned. Simultaneously, a majority of businesses are unlisted. For the mainstreaming of responsible corporate governance, unlisted companies will have to also play a significant role. For such companies, all the additional regulations that are applicable to listed companies comprise the informal category beyond compliance. While the majority of unlisted companies seem to be complying with mandatory criteria, beyond compliance trends do not paint a positive picture.

This study begins with the first introductory section seeking to identify the Indian context – which is central to understanding the mandatory and voluntary regimes in the country as well as compliance performance. Firms with transparent governance structures have traditionally enjoyed better access to capital. There are of course systemic differences between the Indian economy and developed economies with significantly greater market depth. In India, the retail investor plays a nominal role in the capital markets – and in order for the markets to become more efficient, transparent and effective, this reality must gradually change.

The second section deals with the evolution of the regulations and norms around corporate governance and business responsibility. The section charts out the historical context of various policies as well as the cyclical patterns of mandatory and voluntary policies being enforced at different junctures. In order to accommodate for the distinct nature of Indian markets, business environment and economic imperatives, policies have followed deterministic trajectories. That is, the move to mandatory policy has nearly always been preceded by developments in voluntary norms.

The third section outlines the analytical framework employed for the quantitative analysis that has been carried out in the fourth and fifth sections. Essentially, this framework identifies a set of objective parameters which are in turn derived from existing regulations and norms on corporate governance and business responsibility. This analytical framework is employed to assess the disclosure performance (through Annual Reports, Sustainability Reports etc.) of listed and unlisted companies. These parameters vary for listed and unlisted companies.

In the fourth section, through a set of 'objective parameters', the study identifies the corporate disclosure and business responsibility patterns and performance for some of the largest listed companies between 2008 and 2012. Some key trends observed included:

A. While most companies seem to be complying with mandatory provisions, beyond compliance trends on voluntary norms are far from satisfactory levels.

B. The period following the financial crisis saw the largest year-on-year change in compliance with both mandatory and voluntary provisions. The events of the financial crisis seem to have made companies more careful about their performance on regulatory adherence.

C. On a more nuanced level, it is interesting to observe that, in the case that policy changes seem to be in the offing (through suggestive policy guidelines that may be non-mandatory in nature at the outset), the analysed listed companies started to respond to possible changes in the mandatory policy framework as a form of pre-emptive compliance.

D. Furthermore, companies seem to be fairly compliant on mandatory policies around corporate governance such as institution of committees etc, yet when it comes to embedding stakeholder priorities within substantive business operations, performance is dismal.

The fifth section follows up with an objective analysis of some of the largest unlisted companies. A comparison is drawn between the two categories of companies towards the end of section five. While most of the SENSEX companies complied with the mandatory parameters selected (94% in 2012) - only 75% of the unlisted entities complied with mandatory regulations. It was also found that in 2011, around 29% of unlisted companies adopted/claimed to adhere to voluntary norms, while the compliance trend has been increasing from 38% to 53% of the total number of SENSEX companies.

The sixth section presents a synthesis of a number of qualitative stakeholder surveys administered primarily to company secretaries, non executive and executive directors and senior executives of some of the largest corporations in India operating across a multitude of sectors and business segments. Six driving themes have been explored through these one-on-one surveys, namely: promoter dominated businesses and the impact on corporate governance; the roles and responsibilities of independent directors; stakeholder incentives and protection – employees, communities and investors; sustainability and corporate social responsibility (CSR); navigating the policy paradigm – inputs on voluntary and mandatory policies.

The seventh section presents a summary of key findings. Three clear emphasis areas become clear in the context of getting to the core of the drivers of varying degrees of corporate governance and business responsibility performance. Apart from issues around institutional oversight and shortfalls in the construct of the regulatory paradigm, the following key drivers of responsible corporate governance have been identified:

A. **Sector Regulations:** The response to various policies whether mandatory or voluntary, is significantly affected by the sectoral reporting/response trends. That is, in sectors such as banking or broadcasting, sector specific regulations tend to drive compliance and beyond compliance in the context of regulations applicable to the entire spectrum of large companies.

B. **Self Regulation and Global Benchmarks:** In the case of some companies, internal controls are strong for a variety of endogenous reasons. Therefore, the exogenous layer of regulations or prescriptive policies functions only as frameworks or guidance for reporting rather than for instituting internal processes for controls. This is especially true in the context of companies that strive to reach international benchmarks rather than limit themselves to the domestic regulatory framework.

C. **Peer Review and Competitiveness Concerns:** The first stakeholders to analyse public disclosures of various companies are sector competitors. This has been confirmed through the surveys conducted in this report and therefore the role of peer review and the motive of staying competitive within the sector are key drivers of adherence to both corporate governance regulations and business responsibility norms applicable to large listed and unlisted entities in India.

1

Introduction

"The fundamental objective of corporate governance is the enhancement of shareholder value, keeping in view the interests of other stakeholders."

The Birla Committee Report on Corporate Governance

The global financial crisis has forced corporations and governments to look inwards in an attempt to re-imagine frameworks and modalities for effective corporate governance and business responsibility (the responsibility of businesses towards a wide array of stakeholders). In many ways, crises have been stimulants of change throughout the history of institutions and governance. Perhaps not coincidently, in India, the regulatory discourse on corporate governance can be traced back to the post-Asian Financial Crisis era in the late 1990s with the Birla Committee on Corporate Governance (1999).

Multiple studies have shown the correlations between corporate governance, business responsibility and economic development, and the concepts are inherently interlinked. Firms with transparent and responsible (towards stakeholders) governance structures have traditionally enjoyed better access to capital[i]. There are of course contextual differences between the Indian economy and developed economies. In India, the retail investor plays a nominal role in the capital markets – and in order for the markets to become more efficient, transparent and effective, this reality must gradually change.

India has traditionally fared relatively poorly on many of the existing global indices modelled on indicators which consider criteria such as political risk, sector competitiveness, corporate governance performance etc. (see table 1). While the challenges of the political economy in India are systemic and likely to be resolved over a relatively long time horizon, businesses must move ahead and set high benchmarks of performance if they are to become competitive within the contemporary paradigm of increased financial integration and globalisation.

Table 1: Various Indices of Competitiveness of Indian Markets

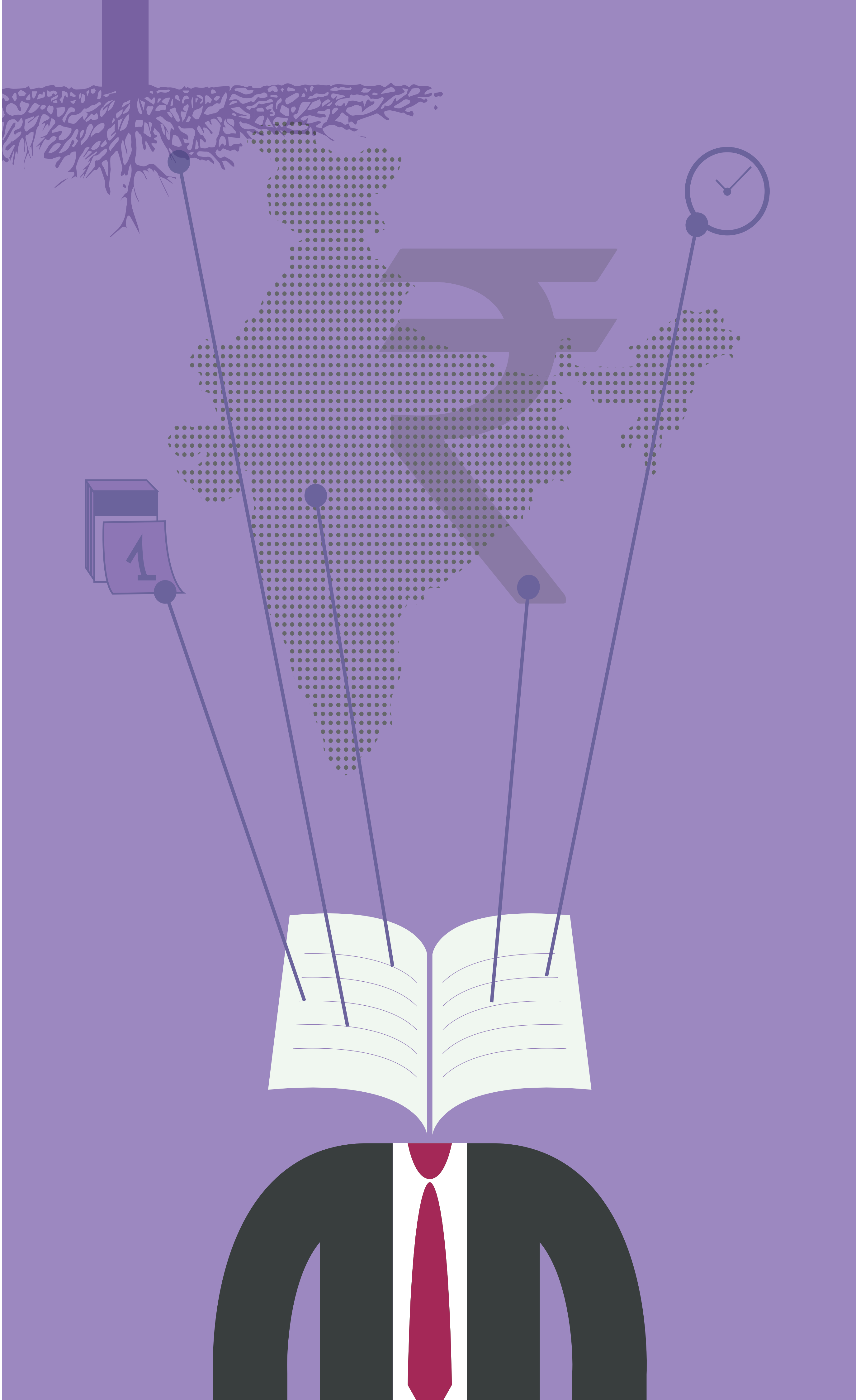
		Year 2012	Year 2011
Index	Organisation	India's Rank/ Total	India's Rank/ Total
Doing Business	World Bank, International Finance Corporation	132/185	134/183
Global Competitiveness Index	World Economic Forum	56/142	51/139
Best Countries for Business 2010	Forbes	NA	94/134
World Competitiveness Scoreboard	International Institute for Management Development	35/59	32/59
Economic Freedom of the World Index	Fraser Institute	123/179	124/179

Regulatory support must act to facilitate efficient markets through strong investor protection in order to prevent expropriation of minority shareholders. This is especially relevant in the Indian context – where promoter-driven businesses are the norm. Concomitantly, policies and laws borrow heavily from Anglo-American prescriptions which are not able to address key systemic issues that drive the failure of responsible corporate governance as defined in the last section of this report.

A recent KPMG study cites a few telling statistics. Around 95% of the listed companies and close to 100% of the unlisted companies in India are family owned (and more often than not family run)[ii]. No doubt, a large proportionate share of the Indian GDP can therefore be attributed to family-owned businesses. Perhaps more importantly in the Indian context, family-owned businesses account for close to 60% of the employment generated in the country. Expropriation of minority shareholders as well as stakeholders that are not in direct control of businesses is therefore a well-documented issue.

The State is also a dominant shareholder in a number of large, employment generating businesses. The preponderance on Public Sector Units (PSUs) can be traced back to the early years of India's independent history. The Indian Government created many superstructures to kickstart vital industries including metals, mining and energy. The governance dynamics in PSUs has been often compared with promoter dominated companies.

This study will attempt to grapple with many of such issues and provide a discursive overview of the prominent trends, debates and impulses that are driving corporate governance and business responsibility. It will empirically analyse some of the largest listed and unlisted corporations in India.



2

A Brief History of Corporate Governance and Business Responsibility Policies in India

Government promulgated policy initiatives in India have followed a cyclical trajectory. In order to accommodate for the distinct nature of Indian markets, business environment and economic imperatives, policies and regulations tend to follow deterministic trajectories. The move to mandatory policy has nearly always been preceded by developments in voluntary policy. While the Companies Act (1956) is the principle legislation providing the overall framework for good corporate governance, the first substantive initiative, was the Birla Committee on Corporate Governance, set up under the auspices of the chief market regulator, the Securities and Exchange Board of India (SEBI)[iii].

2.1 The Birla Committee Report

SEBI appointed the Committee on Corporate Governance on May 07, 1999 under the chairmanship of Shri Kumar Mangalam Birla, a well-known Indian industrialist, to promote and raise the standards of corporate governance in India. The explicit mandate of the Committee was to suggest changes to the listing agreements between companies and stock exchanges, draft a code of conduct for best practices and suggest safeguards against insider trading (a feature common to nascent capital markets, and a prominent problem in the Indian context).

The Birla Committee Report has referred to various other reports on corporate governance including the Report of the Cadbury Committee, the Report of the Greenbury Committee, the Combined Code of the London Stock Exchange, the OECD Code on Corporate Governance and The Blue Ribbon Committee on Corporate Governance. These reports, written by policymakers and market participants in western countries, have acted as benchmarks for Indian policy on similar issues. Indeed, the context setting for India has been identified as a priority area in the Birla Committee Report.

The report ascribes a pivotal role to the Board of Directors in the overall framework of corporate governance. It states that the Board "stewards the company, sets its strategic aim and financial goals and oversees their implementation, puts in place adequate internal controls and periodically reports the activities and progress of the company in a transparent manner to the stakeholders".

The Birla Committee Report also notes that the role of the Board goes beyond ensuring compliance. The awareness and the understanding of responsibilities to stakeholders is a universally mirrored pillar of business responsibility and corporate governance. Compliance to policy, especially in the context of policies that are legally enforceable, is assumed to be a given in the case of large listed companies such as those represented by the Bombay Stock Exchange Sensitive Index (BSE-SENSEX) companies.

2.2 Clause 49 of Listing Agreements

SEBI first implemented the recommendations of the Birla Committee through the enactment of Clause 49 of the Listing Agreements in 2000-01. This was a clear shift from voluntary to mandatory, completing the first cycle of evolution. The regulatory provisions under Clause 49 were applied to companies in the BSE 200 and S&P C&X Nifty indices, and all newly listed companies, on March 31, 2001. From March 31, 2002 onwards they became applicable to companies with a paid-up capital of INR 10 crore or with a net worth of INR 25 crore at any time in the past five years, as of March 31, 2002; and finally to other listed companies with a paid-up capital of over INR 3 crore on March 31, 2003.

Clause 49 deals with multiple issues that are central to ensuring a coherent corporate governance and business responsibility framework. These include defining the role, duties and obligations of Directors of the Board (independent and executive); remuneration to non-executive directors; term of appointment for non-executive directors; requirements related to audit committees of the Board; audit reports and qualifications; whistle blower policy; internal audit policies; disclosure of contingent liabilities; related party transactions; CEO/CFO certifications; allocation of proceeds from initial public offerings.

2.3 The Narayana Murthy Committee Report

In the wake of the large-scale corporate scandals in the West and the enactment of the Sarbanes-Oxley Act (SOX), 2002 in the United States, the regulatory set up in India as well as the largest Indian multinationals, were put under pressure to rethink the existing governance paradigm. Consequently, the Narayana Murthy Committee was set up in 2002-03 and submitted a fresh set of recommendations on corporate governance to SEBI in August 2003. These recommendations were an attempt to re-evaluate the Birla Committee Report and suggested substantive changes which were not immediately accepted by industry stakeholders. After multiple rounds of stakeholder consultations (and iterations to the original draft) the Committee's revised recommendations were finally accepted on October 29, 2004. Corporate Governance analysts have termed it a "diluted" version of the originally proposed draft[iv]. The trajectory of reforms followed a cyclical pattern which has been alluded to earlier.

Box 1: The Sarbanes-Oxley Act (SOX)

What is SOX?

The Act was drafted in 2002 to protect investors by improving the accuracy and reliability of corporate disclosures. The Act created new and stricter standards for corporate accountability and enforced a robust penalty system. Senator Paul Sarbanes and Representative Michael Oxley of the US drafted the Sarbanes-Oxley Act (SOX).

Who does it apply to?

SOX applies to all public companies in the US and international companies that have registered equity or debt securities with the Securities and Exchange Commission and the accounting firms that provide auditing services to them.

Why did US Congress enact SOX?

In the run-up to the passage of the Act, the US business community experienced a number of corporate scandals including Enron, WorldCom and Tyco. Each of the scandals resulted from misrepresentation of different types of transactions, fabrication of financial records and a complete lack of accountability in the context of decision making by senior executives and Board members of the companies. For instance, Enron's financial statements did not accurately depict the nature of institutional relationships, financial transactions and business operations. Shareholders and analysts were grossly misled through creative and unethical accounting practices. In fact, Enron's external auditor, Arthur Anderson, was charged with and found guilty of obstruction of justice for shredding the thousands of documents and deleting e-mails and company files that tied the firm to its audit of Enron, and the firm was effectively put out of business.

What does SOX aim to achieve?

SOX aims to enhance corporate governance and stakeholder accountability. It does that by formalising and strengthening internal checks and balances within corporations. A CEO or CFO who submits a wrong certification is subject to a fine of up to $ 1 million and imprisonment for up to ten years. Two particularly relevant provisions are:

Section 302: A mandate that requires senior management to certify the accuracy of the reported financial statement.
Section 404: A requirement that management and auditors establish internal controls and reporting methods on the adequacy of those controls.

The final report dwelled on eight prominent themes including the composition of the Board and specifically the appointment, role and definition of independent directors; shareholders awareness and role in remuneration of non-executive directors; composition of audit committees and specific recommendations that have been enacted via Clause 49 on the composition and role of these committees; management of subsidiary entities; disclosures on related party transactions; risk assessment procedures; certification of CEO/CFO for annual financial statements (based on SOX); and the format for filing of quarterly compliance disclosure stating adherence (or explanation otherwise) to Clause 49.

SEBI amended Clause 49 by issuing a circular (see annexure 1) to the managing directors/executive directors/administrators of all the stock exchanges in India. The circular superseded all previous circulars issued by SEBI on Clause 49 and stock exchanges were directed to set up a separate monitoring cell with identified personnel to monitor the compliance with the provisions of the revised Clause 49 on corporate governance. Moreover, the stock exchanges were directed to ensure that all the revised provisions were adhered to by new companies seeking listing.

2.4 The Naresh Chandra Committee and Corporate Governance Voluntary Guidelines - 2009

Following a host of corporate governance scandals including the Satyam Scandal, the Confederation of Indian Industry (CII), under the aegis of the central government, set up a task force under the chairmanship of Naresh Chandra to deliberate on further improvements to the corporate governance benchmarks and practices prevalent in the country. The task force's recommendations were taken on board by the Ministry of Corporate Affairs after a robust feedback process with industry stakeholders in the form of the 'Corporate Governance Voluntary Guidelines 2009' in December 2009. The Preamble to the guidelines states that the guidelines would be reviewed after one year once industry stakeholders adopt and respond to them.

Box 2: The Satyam Scandal

The Satyam Scandal was an accounts fraud carried out by a senior executive of an Indian IT corporate - Satyam Computer Services Ltd. in 2009. The company's profits had been drastically inflated over years to an amount of around $ 1 billion. The scandal not only put question marks over India's corporate governance regulations and oversight, but also threatened foreign investments. Satyam was considered a role model for compliance to corporate governance principles in India. Satyam's CEO Ramalinga Raju admitted to have created fictional assets by manipulating accounts over years, while the company's auditors Pricewaterhouse Coopers failed to detect irregularities.

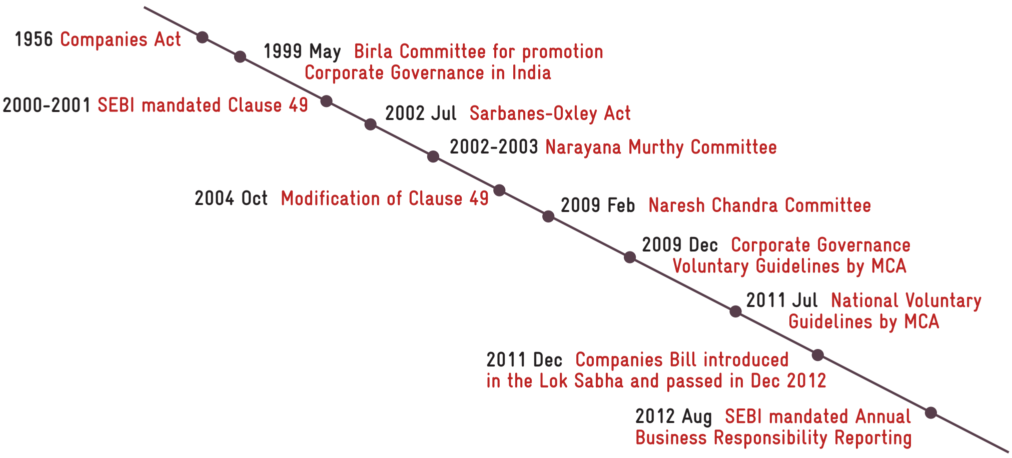
The new/prominent issues dealt with by the guidelines include the setting up of a Nominations Committee comprising a majority of independent directors (including its chairman) for appointing, through a rigorous framework of evaluation, independent and non-executive directors; the desirable attributes of independent directors; training of directors in order to build skill sets and understand basic documents of the company including financial information; the strengthening of the Audit Committee and broadening of roles and responsibilities as well as rotation of audit partners and firms.

2.5 The Companies Act, NVGs and SD Guidelines for PSUs

The Corporate Governance Voluntary Guidelines 2009 touch upon a number of thematic focus areas which are mirrored in sections of the latest piece on regulation which has immediate consequences for corporate governance. The original form of the Companies Bill (introduced to replace the existing Companies Act, 1956) was introduced in the Lower House on October 23, 2008 and it lapsed due to the dissolution of the 14th Lok Sabha. After two more iterations, the Companies Bill, 2011 was introduced in Lok Sabha on December 14, 2011 and thereafter the Companies Bill, 2012 (Bill) was passed by Lok Sabha on December 18, 2012, replacing the 56-year-old Companies Act, 1956.

The new act details regulations for the appointment, functioning and tenure of independent directors. There is also particular emphasis on transparency in the Corporate Governance reports of companies; guidance on the rotation of auditors and related party transactions/appointments; the roles and responsibilities of Audit Committees; provisions for internal audits etc. The independence of independent directors and the role of internal and external audits in protecting stakeholders are perhaps the most emphasised and relevant portions of the legislation to this study.

Within the business responsibility domain, the National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business (NVGs) were notified by the Ministry of Corporate Affairs in 2011. There are a number of suggestions around ethics, transparency, accountability etc. There are also suggestions on institutionalisation of environment management systems, reporting on environmental performance, and the persuasion and support throughout the value chain for adopting better awareness of material risks.



Based on the NVGs, the Ministry of Corporate Affairs has introduced a new format for reporting (which has been mandated by SEBI as of August 13, 2012 for the largest listed 100 companies by market capitalisation in India) called the Annual Business Responsibility Report (ABRR). Notably, the guidelines use the term 'Responsible Business' instead of 'Corporate Social Responsibility' (CSR). Therefore many of the Nine Principles enshrined by the NVGs go beyond the traditional mandate of CSR.

For Public Sector Units (PSUs) the, the Department of Public Enterprises of the Ministry of Heavy Industries and Public Enterprises in 2012 promulgated Sustainable Development (SD) Guidelines as the most recent government initiative to promote business responsibility within Central Public Sector Enterprises (CPSEs). Adherence to SD Guidelines has become mandatory (by MoUs) for profitable CPSEs which have to attribute 5% to 10% of their annual profits to sustainability initiatives.

The SD guidelines function as a tool to enable CPSEs to conceptualise projects, activities, expenditures and monitoring in the context of sustainable development. In case of non-compliance with the guidelines, public enterprises have to report to shareholders and indicate the reasons. The precedents for attempting to incorporate sustainable growth strategies for public sector businesses are the Voluntary Guidelines on Corporate Governance, 2007 and the Corporate Social Responsibility Guidelines, 2010.

3

Analytical Framework for Analysis of Trends

This report will analyse responses by the largest Indian corporations to many of the mandatory policies and voluntary norms that have evolved over the past decade in India. It will do so in two parts: through an objective assessment of disclosures on corporate governance and business responsibility performance of SENSEX 30 companies across 2008-12 and 30 of some of the largest unlisted companies across 2008-11[v]; and through targeted stakeholder surveys[1]. The universal set of regulations and benchmarks that are considered within this study are outlined within the context of three overarching questions as outlined here and are further divided into role/approach of management and disclosure performance[vi]:

Driving Question 1: What are the governance structures in place to respond to mandatory and voluntary policies and guidelines? What are the patterns of compliance and beyond compliance actions/ disclosures?

Disclosures on Corporate Governance:

Role/Approach of Management	Disclosure Performance
• What is the process for approval of the report? Who is responsible for drafting it? • What is the structure of internal control? Who is the executive authority?	• Section Available Online? • Statement of Board members' responsibilities toward stakeholders?

[1] None of the responses to the surveys are attributed herein. The Companies Act referred to in the rest of the document is the Act as it existed before the latest amendments referred to earlier in the report.

Ownership Structure and Appointment of Board Members/Senior Executives:

Role/Approach of Management	Disclosure Performance
• Existence of a Nominations Committee of the Board to enable recruitment of independent members? • Are there executive sessions held by independent directors to evolve consensus on important strategic issues?	• Reporting of ownership based on categories of promoters, DFIs, FFIIS, MFs. foreign holdings, other corporate bodies etc? • Roles and responsibilities of independent directors in protecting shareholders?

Committees and their Role in Promoting Good Corporate Governance and Business Responsibility:

Role/Approach of Management	Disclosure Performance
• Regular discussions with auditors about internal control systems, scope of audit and annual financial disclosures? • Existence of Remuneration Committee? • Existence of Ethics Subcommittee? • Existence of Sustainability Committee?	• Existence and disclosure of composition of Audit Committee? • Disclosure of appointed committees? • Explicit disclosure of roles of the respective committees?

Driving Question 2: What is the level of Board and senior executive oversight and business responsibility?

Management Structure and Strategic Oversight:

Role/Approach of Management	Disclosure Performance
• Separation of chairman of the Board and chief executive officer? • Existing procedure to inform Board members about risk assessment (any possible public or product liability) and minimisation procedures? • How are Board members given access to accurate, relevant and timely information about firm level sustainability initiatives?	• Management Discussion and Analysis (MD&A) report provides discussion on material developments in HR, industrial relations front, including people employed? • Quarterly report certified by company with stock exchanges on business risks etc? • Explicit outlined sustainability strategy in the MD&A report?

Managerial Training, Awareness Building, Performance Building:

Role/Approach of Management	Disclosure Performance
• Board level training programmes to build expertise and competency on materially relevant themes?	• Stakeholder awareness building of company's long term objectives through annual reports?
• Existence of performance enhancement mechanisms for employee participation ?	• Disclosure of senior management salaries, stock options and bonuses?

Driving Question 3: What are the oversight measures in place? What is the level of accountability to various stakeholder groups?

Stakeholder Grievance/Priorities Redressal Mechanisms and Processes:

Role/Approach of Management	Disclosure Performance
• Existence of investor grievance committee chaired by a non-executive director?	• Whistle Blower Policy reported (on website/annual report)? Code of conduct reported?
• Is there a whistle blowing policy mechanism in place for employees to voice concerns on ethics etc?	• Institutional investors acting in a fiduciary capacity disclose their voting policies with respect to their investments?
• Existing mechanism for facilitation of ownership rights of all stakeholders including institutional investors?	

Energy Consumption and Conservation Disclosures:

Role/Approach of Management	Disclosure Performance
• What is the level of management involved with oversight of energy use? • What is the role of Board in evaluating/ acting upon any impact assessment in the context of energy conservation? • Existence of Environmental Management Systems?	• Board reports on the energy conservation measures by the company? • Reporting of impact assessment in the context of energy conservation ? • Appropriate Form A disclosure in case of energy intensive industrial segments if applicable? • Global Reporting Initiative (GRI) or any other established international standard for sustainability reporting followed?

Independence of Auditors:

Role/Approach of Management	Disclosure Performance
• Robust systems for internal audit and oversight? Role of Audit Committee in internal audit functions? • Procedures for appointment of auditors and maintenance of independence in accordance with Sec 226 of Companies Act, 1956?	• Audit certification/report within annual report? • Compliance certificate for compliance of conditions of corporate governance/or explanation for non compliance? • Certificate of independence of auditor from company assessed?

4

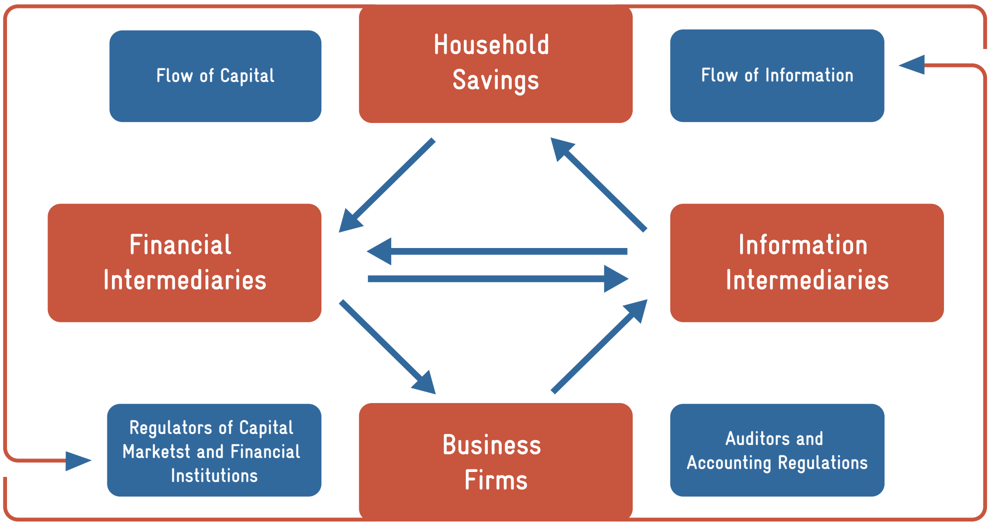
Assessment of Disclosure Trends of SENSEX 30 Companies

In this section, trends of compliance and beyond compliance reporting and practices of SENSEX 30 companies will be analysed in some detail (See Annexure 2 for a detailed list of companies assessed). The objective is to get an overview of how the largest corporate entities disclose information to relevant market stakeholders. The compliance and beyond compliance trends, as previously mentioned in this report, draw from existing regulations, benchmarks and guidelines within the context of the Indian markets.

Large listed corporate entities account for a significant proportion of Indian Gross Domestic Product (GDP). The top 30 companies by market capitalisation listed on the Bombay Stock Exchange themselves approximate to around 15 per cent of GDP at current prices. Such entities simultaneously also account for significant proportions of employment generated, carbon emissions, profits returned to shareholders etc.

Corporate disclosures are pivotal in driving transparency. Historically, the concept of disclosures has evolved as a measure to respond to principal-agent problems between managers of companies and shareholders. Optimal contracts between companies and their public investors, in theory, are supposed to provide incentives for full disclosures of private information, therefore circumventing the asymmetries in information that might occur in markets and lead to undervaluation or overvaluation of traded securities . The figure here based on Healy et. al. (2001) neatly illustrates the "role of disclosure, and information, and financial intermediaries in the working of capital markets".

Information and Investment Flow in the Markets



The above figure illustrates that there are two ways in which household savings in an economy can reach publicly listed corporate entities. The direct route is straight from the savers to businesses and examples include equity financing and angel investing. The second way is indirect, through financial intermediaries such as banks, pension funds and mutual funds. In both cases, the role of disclosures by the corporate entity in question is pivotal. In both cases, firms communicate with external market participants, whether directly to the investor through the media, public disclosure etc, or through financial intermediaries which are normally privy to more information.

A variety of economic and institutional factors determine whether the information finally communicated to the household savers is accurate, timely and relevant or if there is information asymmetry. Within this context it is also important to note that most modern day regulations on corporate governance and business responsibility assume a diffusion of ownership (through public shareholding). Annual reports are public disclosure documents that are mandated by law, and have sections that consist of responses to various mandatory and voluntary requirements (which vary from sector to sector). This section will analyse such disclosures which are proxies of institutional transparency and consistency.

The section is divided into six parts as follows (the sections can be seen within the context of the overarching driving questions described in the previous section):

4.1 Mandated Disclosures on Corporate Governance

This subsection investigates disclosure responses to four parameters. They are as follows:

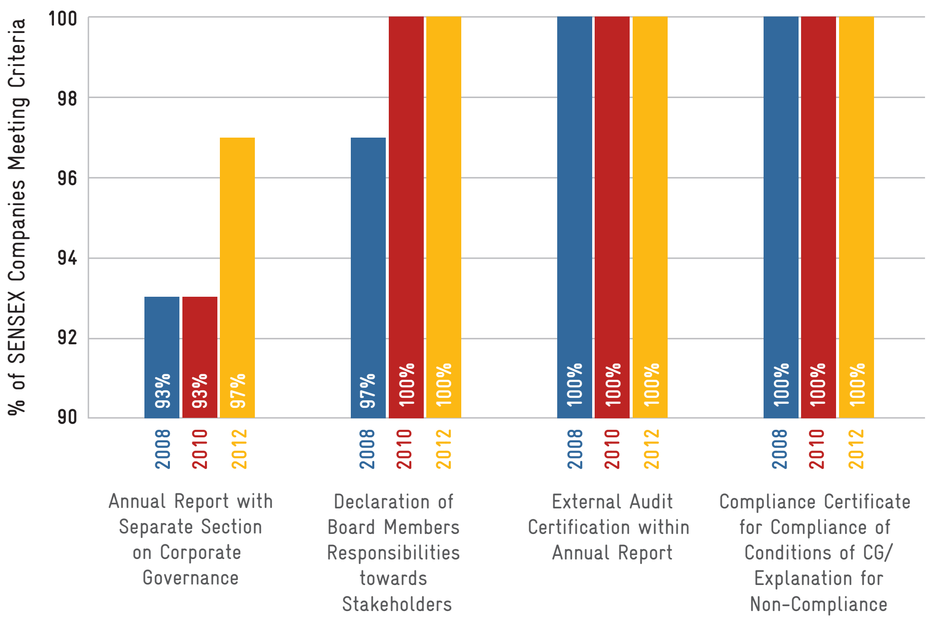
#	Parameter	Derived from Regulation /Policy Guidance	Further Context
1	**Separate section on corporate governance in annual reports** (Mandatory)	According to SEBI's Clause 49, Part VI: "There shall be a separate section on Corporate Governance in the Annual Reports of companies, with a detailed compliance report on Corporate Governance..."	First suggested by the Kumar Mangalam Birla Committee on Corporate Governance, in section 15.6: "The Committee recommends that there should be a separate section on Corporate Governance in the annual reports of companies..."
2	**Declaration of Board Members Responsibilities towards Stake-holders** (Mandatory)	Section 217 (2AA) of Companies Act, 1956 states that: "The Board's report shall also include a Directors' Responsibility Statement, indicating therein, – (i) That in the preparation of the annual accounts, the applicable accounting standards had been followed along with proper explanation relating to material departures ..."	In the Company's Bill, 2011, an additional sub-clause on internal controls has been added to supplement the requirement of Section 217 (2AA), which in the Companies Bill, 2011 is laid out under Clause 143 (5) as: "the directors, in the case of a listed company, had laid down internal financial controls to be followed by the company and that such internal financial controls are adequate and were operating effectively."
3	**External Audit Certification within Annua Report** (Mandatory)	Section 227 of the Companies Act, 1956, states that: "The auditor shall make a report to the members of the company on the accounts examined by him, and on every balance sheet and profit and loss account and on every other document declared by this Act to be part of or annexed to the balance sheet or profit and loss account, which are laid before the company in general meeting during his tenure of office, and the report shall state whether, in his opinion and to the best of his information and according to the explanations given to him, the said accounts give the information required by this Act in the manner so required and give a true and fair view – (i) in the case of the balance sheet, of the state of the company's affairs as at the end of its financial year; and (ii) in the case of the profit and loss account, of the profit or loss for its financial year."	The Companies Bill, 2011 has a similar provision in Clause 143 (2). The auditor's responsibility is to express an informed opinion on whether the management has fairly presented the information in disclosed financial statements. During the audit, the external auditor collects evidence to obtain reasonable assurance that the amounts and disclosures in the financial statements and other components of public disclosure documents such as the MD&A report are free of material misstatements.

#	Parameter	Derived from Regulation /Policy Guidance	Further Context
4	**Compliance Certificate for Compliance of Conditions of CG/ Explanations of Non Compliance** (Mandatory)	Part VI of SEBI's Clause 49, states that: "The companies shall submit a quarterly compliance report to the stock exchanges within 15 days from the close of quarter as per the format given in Annexure I B. The report shall be signed either by the Compliance Officer or the Chief Executive Officer of the company."	First suggested by the Kumar Mangalam Birla Committee on Corporate Governance, in part 15.6: "Non-compliance of any mandatory recommendation with reasons thereof and the extent to which the non-mandatory recommendations have been adopted should be specifically highlighted."

All four parameters are mandatory in nature. Two of them are mandated by the Companies Act and the other two by SEBI's Clause 49 agreement between stock exchanges and companies. Overseeing adherence to the Companies Act is the ambit of the Ministry of Corporate Affairs, which in turn has two quasi legal agencies – the Company Law Board and the Serious Fraud Investigation Office. On the other hand, the most severe penalty for non compliance with Clause 49 is delisting of the defaulting companies from stock exchanges, a penalty which is seldom enforced . Stock exchanges can refer specific cases of non compliance to SEBI. While stock exchanges have responsibility for surveillance, they do not have punitive authority over non compliant companies.

Most of the analysed SENSEX 30 companies complied with all four mandatory parameters in 2012. All parameters are highly objective in their construct. However, while the parameters are objective, there can be large qualitative differences between the performance of reporting between one company and another which cannot necessarily be captured through a binary assessment.

Mandate Disclosures on Corporate Governance



4.2 Ownership and Remuneration

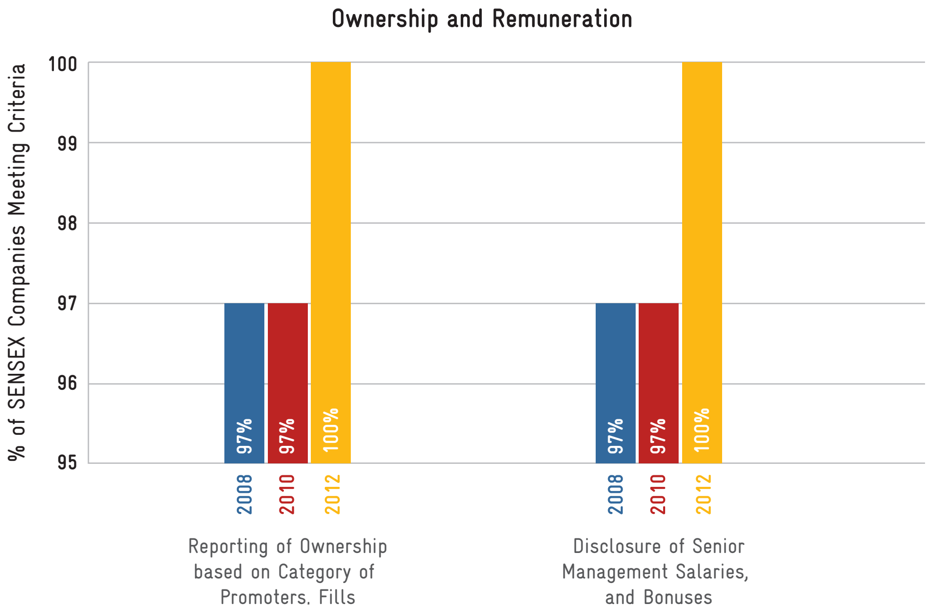
This subsection investigates disclosure responses to two parameters. They are as follows:

#	Parameter	Derived from Regulation/Policy Guidance	Further Context
1	**Reporting on Ownership based on Categories of Promoters** (Mandatory)	There are two mandatory requirements relating to this parameter in SEBI's Clause 49. The first is in Section E (iv): "The company shall disclose the number of shares and convertible instruments held by non-executive directors in the annual report." The second is a line item in annexure 1C of Clause 49, on the "Suggested List of Items to Be Included In the Report on Corporate Governance in the Annual Report of Companies" under the subheading "General Shareholder Information: Distribution of shareholding".	"Distribution of shareholding" is mentioned as a line item in the "Suggested List Of Items To Be Included In The Report On Corporate Governance In The Annual Report Of Companies" in the Narayana Murthy Report on Corporate Governance, 2003.
2	**Disclosure of Senior Management Salaries and Bonuses** (Mandatory)	There are two pieces of regulations which ask for this information. Under the Companies Act, 1956, General Instructions for Preparation of Statements of Profit and Loss it is ordained that "A Company shall disclose by way of notes additional information regarding aggregate expenditure and income on the following items:- (i) (a) Employee Benefits Expense [showing separately (i) salaries and wages..." In provision (E) of Clause 49, it is stated that "disclosures on the remuneration of directors shall be made in the section on the corporate governance of the Annual Report".	Section 134 of the Companies Bill, 2011 also states that "in case of listed companies, the "company's policy on directors' appointment and remuneration including criteria for determining Qualifications..." in the form of a report by the Board, must be placed at general meetings.

Existing research suggests that the texture of corporate governance differs based on the underlying ownership structure of firms. There can be multiple distinct ownership patterns, each generating different structural outcomes in the context of governance. According to Chakrabarti et al. (2006), around 60% of India's 500 largest companies by market capitalisation were affiliated with family business groups with controlling interest[xi].

Later parts of this study will qualitatively examine the implications of this ownership structure in the context of corporate governance. **All SENSEX companies analysed here complied with the objective parameter on reporting of ownership in FY 2012.**

According to a 2009 OECD report, "Remuneration schemes are often overly complicated or obscure in ways that camouflage conditions and consequences.



They also tend to be asymmetric with limited downside risk thereby encouraging excessive risk taking". Notably, it also goes on to state that "Transparency needs to be improved beyond disclosure. Corporations should be able to explain the main characteristics of their performance related remuneration programmes in concise and non-technical terms. This should include the total cost of the programme; performance criteria and; how the remuneration is adjusted for related risks."

All SENSEX companies analysed here disclosed basic remuneration details of senior management in 2012 and the compliance trend across 2008-2012 has been positive.

4.3 Committees for Enhancing Corporate Governance

This subsection investigates disclosure responses to four parameters. They are as follows:

#	Parameter	Derived from Regulation /Policy Guidance	Further Context
1	**Audit Committee** (Mandatory)	Section 292A of the Companies Act, 1956, states that: "Every public company having paid-up capital of not less than five crore of rupees shall constitute a committee of the Board known as "Audit Committee" which shall consist of not less than three directors and such number of other directors as the Board may determine of which two-thirds of the total number of members shall be directors, other than managing or whole-time directors." Clause 49 prescribes that two-thirds of the members should be Independent Directors.	All major policy suggestions, and the current impending legislation in the Indian Parliament, the Companies Bill, 2011, ascribe an important role to the Audit Committee. Section 177 of the Bill states that "The Board of Directors of every listed company and such other class or classes of companies, as may be prescribed, shall constitute an Audit Committee."
2	**Remuneration or Compensation Committee** (Voluntary – before Companies Bill (2012))	Annexure 1 D (non mandatory agreements) of SEBI's Clause 49, Annexure states that: "The board may set up a remuneration committee to determine on their behalf and on behalf of the shareholders with agreed terms of reference, the company's policy on specific remuneration packages for executive directors including pension rights and any compensation payment." Furthermore, the Naresh Chandra Committee report also states that: "It should have delegated responsibility for setting the remuneration for all executive directors and the executive chairman, including any compensation payments, such as retiral benefits or stock options. It should also recommend and monitor the level and structure of pay for senior management, i.e. one level below the Board."	The Companies Act, 1956, does not ascribe any such voluntary provision for Board level remuneration; Section 309 state that "The remuneration payable to the directors of a company, including any managing or whole-time director, shall be determined, in accordance with and subject to the provisions of section 198 and this section, either by the articles of the company, or by a resolution or, if the articles so required, by a special resolution, passed by the company in general meeting and the remuneration payable to any such director determined as aforesaid shall be inclusive of the remuneration payable to such director for vservices rendered by him in any other capacity...".

#	Parameter	Derived from Regulation /Policy Guidance	Further Context
3	**Investor Grievance Committee** (Mandatory)	SEBI's Clause 49, Part G, states the mandatory provision that "A board committee under the chairmanship of a non-executive director shall be formed to specifically look into the redressal of shareholder and investors complaints like transfer of shares, non-receipt of balance sheet, non-receipt of declared dividends etc. This Committee shall be designated as 'Shareholders/ Investors' Grievance Committee."	EBI has been empowered by the Department of Company Affairs to file complaint against defaults of some specific provisions of the Companies Act, 1956. These relate to primary market operations, delays in issue of shares, refund of excess application money, delays in dispatch of dividends etc. SEBI can also impose penalties on companies for failure to redress investor grievances.
4	**Sustainability Committee** (Voluntary)	While not a mandatory provision in any of the existing regulations (or the Companies Bill), the mandate for sustainability is generally overseen by such committees the world over. In India, the NVGs issued by the Ministry of Corporate Affairs prescribes nine principles which cover the broad array of issues under the aegis of sustainability (and the emphasis on the stakeholder is prominent).	The United Nations (UN) Global Compact Principle 7 states that ""Businesses should support a pre-cautionary approach to environmental challenges". According to the UN, such precautionary approaches are in turn to be developed through among other methods: creating "a managerial committee or steering group that oversees the company application of precaution, in particular risk management in sensitive issue areas" and through establishing a "two-way communication with stakeholders, in a pro-active, early stage and transparent manner…"

The origins of Audit Committees can be traced back to the second half of the 19th century according to some analysts[xii]. The Baltimore and Ohio (B&O), formed in 1827, the first major railroad project undertaken in the US, had an Audit Committee of shareholders. Mandated by law across most countries, Audit Committees perform crucial oversight functions in a company, and all 30 companies analysed here have disclosed the existence and functions of their Audit Committees.

In Clause 49, Audit Committees are mandated to comprise two-thirds independent directors, while the rest can be any other members of the Board. The Naresh Chandra Committee has pointed this provision out as a flaw, stating that this "runs counter to a fundamental operating principle of good corporate governance, namely that the Audit Committee must comprise entirely of non-executive directors with independent directors forming majority"[2].

The existence of a Shareholder's/Investor Grievance Committee is also mandated by law. In the case of this Committee, except for the fact that the mandate is for the chairman of the Committee to be a non-executive director there are no particular mandatory policy prescriptions on composition etc. In the context of protection of stakeholders, the Committee is supposed to play an important role and once again it was found that all SENSEX companies analysed here have disclosed the existence and composition of their respective Shareholder's/Investor Grievance Committees. **In the compliance trends analysed, all SENSEX companies had both the mandatory committees is place in 2012.**

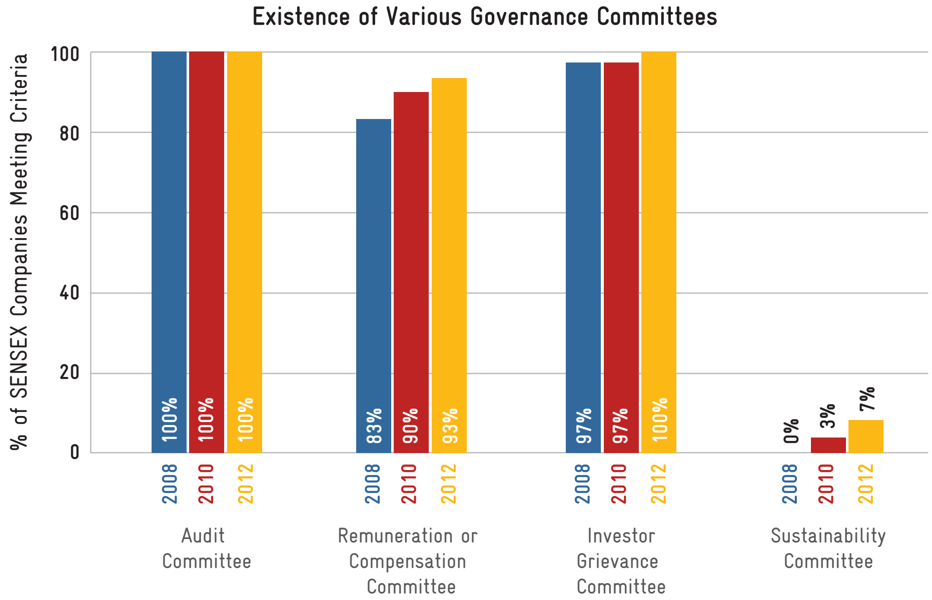
However, unlike the Audit Committee or the Investor Grievance Committee, both of which are outcomes of regulation as well as function (as demonstrated by the case of the Railway company), the Remuneration Committee is not covered by any mandatory policy. **However, there are clear policy trends towards mandating Remuneration Committees and SENSEX companies analysed here seem to be geared up for this regulatory change since nearly all of them are already compliant and the trend across time has been positive.**

The Naresh Chandra Report for instance states that all listed companies should have a Remuneration Committee. And, the Companies Bill, 2011 made an unambiguous case for it in Section 178: "The Board of Directors of every listed company and such other class or classes of companies, as may be prescribed shall constitute the Nomination and Remuneration Committee consisting of three or more non-executive directors out of which not less than one half shall be independent directors."

The Sustainability Committee on the other hand is an aspiration for now. Global best practices and benchmark principles for corporate governance such as the UN Global Compact allude to the existence of such a committee; however, it has not been prescribed by any of the official (SEBI or Ministry of Corporate Affairs) reports on corporate governance. Moreover the Companies Bill, 2011, does not make a clear case for sustainability, but rather has focused on mandating a CSR Committee through Section 135: "Every company having net worth of INR 500 crore or more, or

[2] To most of the stakeholders interviewed in the process of compiling this report, the composition of the Audit Committee in terms of cut-offs for the numbers of non-exclusive directors etc. were trivial issues compared to the overall functioning and effectiveness of the committee which seemed to be predominant issues. These issues of composition will be taken in up some detail in the qualitative analysis to follow in the report.

turnover of INR 1,000 crore or more or a net profit of Rs five crore or more during any financial year shall constitute a Corporate Social Responsibility Committee of the Board..." **Not surprisingly, very few companies have sustainability committees in place, since neither regulation of suggestive policy prescriptions indicate that these will be made mandatory.**



4.4 Strategic Oversight and Disclosure

This subsection investigates disclosure responses to three parameters. They are as follows:

#	Parameter	Derived from Regulation /Policy Guidance	Further Context
1	**MD&A Provides Discussion on Material Developments** (Mandatory)	According to SEBI's Clause 49 Listing Agreements, (iv) Part F "As part of the directors' report or as an addition thereto, a Management Discussion and Analysis report should form part of the Annual Report to the shareholders. This Management Discussion & Analysis should include discussion on the following matters within the limits set by the company's competitive position: ...8. Material developments in Human Resources / Industrial Relations front, including number of people employed."	The inclusion of the aforementioned mandatory provision in Clause 49 followed recommendations from the Birla Committee Report which also states that "Good corporate governance casts an obligation on the management in respect of disclosures. The Committee therefore recommends that disclosures must be made by the management to the board relating to all material financial and commercial transactions, where they have personal interest that may have a potential conflict with the interest of the company at large..."

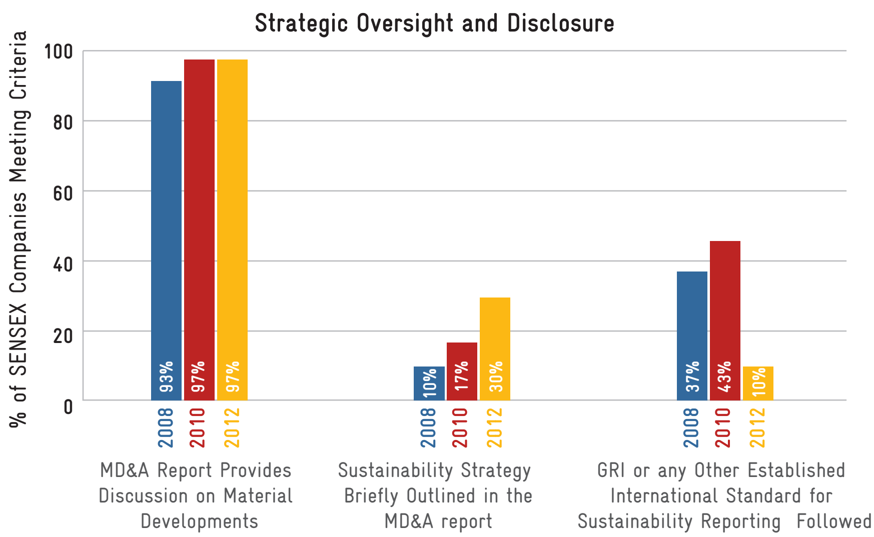
#	Parameter	Derived from Regulation /Policy Guidance	Further Context
2	**Sustainability Strategy Briefly Outlined in the MD&A Report** (Voluntary)	This is not a mandatory requirement and under the Ministry of Corporate Affairs NVGs, there are a number of voluntary principles that deal with this theme. However, this indicator has been developed in this report using the United Nations Global Compact Principle 8: "Businesses should undertake initiatives to promote greater environmental responsibility", under which an explicit mention is that companies should define "vision, policies and strategies to include the 'triple bottom line' of sustainable development – economic prosperity, environmental quality and social equity".	The outlining of the sustainability strategy in the MD&A report also helps to establish the material priorities for the company concerned. It is a direct value statement of how the company views sustainability concerns, opportunities within the framework of corporate governance, operational and enterprise efficiency.
3	**Sustainability Report Published** (Mandatory[3])	In a circular to listed companies issued on August, 13 2012, SEBI advised that in line with the National Voluntary Guidelines of the Ministry of Corporate Affairs "and considering the larger interest of public disclosure regarding steps taken by listed entities from an Environmental, Social and Governance (ESG) perspective, it has been decided to mandate inclusion of Business Responsibility Reports (BRR) as part of the Annual Reports for listed entities. Therefore, in line with the objective to enhance the quality of disclosures made by listed entities, certain listing conditions are hereby specified by way of inserting Clause 55 in the Equity Listing Agreement..." Within the BRRs, Section D as per the mandated structure is supposed to state whether the "Company publish a BR or a Sustainability Report? What is the hyperlink for viewing this report? How frequently it is published?"	According to the same circular, the applicability of the mandate extends to the "top 100 listed entities based on market capitalisation at BSE and the National Stock Exchange (NSE) as on March 31, 2012". Moreover it states that "BSE and NSE shall independently draw up a list of listed entities to whom the circular would be applicable based on the said criteria and disseminate the same in their websites respectively. Other listed entities may voluntarily disclose BRRs as part of their Annual Reports. Those listed entities which have been submitting sustainability reports to overseas regulatory agencies/stakeholders based on internationally accepted reporting frameworks need not prepare a separate report for the purpose of these guidelines but only furnish the same to their stakeholders along with the details of the framework under which their BR Report has been prepared and a mapping of the principles contained in these guidelines to the disclosures made in their sustainability reports."

[3] It should also be noted that at the time of writing (November 12, 2012) all the companies assessed for 2012 that usually (as per the assessed trend) publish sustainability reports had not published them yet and therefore the asymmetric reporting pattern. This is not necessarily an indication of diminishing performance across 2008-12 in the case of sustainability reporting.

MD&A reports as a component of Annual Reports of companies were first instituted by the Securities and Exchange Commission (SEC), the chief market regulator of the US government many decades ago. In 1974, the SEC required that corporate annual reports include a discussion and analysis of the summary of operations . Later in the 1980s, the SEC changed the scope of the MD&A to including financial statements as a whole – therefore encompassing a wide range of parameters including risk management, operational overview, strategic long term goals etc. Similar trends in regulation have been mirrored across nations, including India. The MD&A presents an opportunity for corporates to communicate material developments and operational opportunities and challenges in a relatively simple/easy to read format.

Materiality analysis can help the organisations to: elucidate issues driving long-term value; identify, prioritise and address resource and financial risks; identify and capture business opportunities and challenges such as political risk; align business sustainability and risk mitigation; build and maintain reputation; assess corporate performance over time. Therefore the material discussions in the MD&A are a robust basis for identification of key issues through succinct and coherent analysis. They also enable stakeholders including employees and shareholders to hold the management accountable. **Among the companies analysed, 29 out of 30 provided management discussion on material issues in 2010 and 2012.**

The discussion on material issues forms a mandatory part of the annual report. **However, on the other hand, there only voluntary recommendations exist on disclosure of sustainability strategies and concomitantly a sharp drop off in compliance.** Similarly, there is low compliance in the case of sustainability reports. The Global Reporting Initiative (GRI) defines a sustainability report as "a single, consolidated disclosure that provides a reasonable and balanced presentation of performance over a fixed time period".



BRRs have only recently been mandated by policy for the largest 100 listed corporations and the response by corporations to the policy change can be assessed late next year. **However, five corporations reported on the nine NVG principles, as shown in the table below, even before the ABRR format was mandated by SEBI - indicating that pre-emptive reporting is an established trend in the case of the specific policy prescriptions embedded within the NVGs.**

	Wipro	TATA Steel	ITC	Infosys	Mahindra
Principle 1	Establishment of Sustainability Council Corporate Code of Business Conduct Whistle Blowing Policy	Corporate Code of Conduct Management of Business Ethics (Leadership, Communication & Awareness, Compliance Structure, Evaluation of Effectiveness)	*	Code of Conduct Whistleblower Policy Risk Management Framework	Mentions 3 Codes of Conduct Mentions the Existence of Various Governance Policies
Principle 2	Measures for Life Cycle Sustainability for IT Products, Consumer Care and Lightening	Conducting Life Cycle Assessments for ensuring Product Safety and Optimal Utilisation of Resources Educating consumers on Product Properties, Safety, Disposal, Improving Manufacturing and Technology Processes, Fostering Innovation, Recycling Measures...	Compliance of ITC Products and Standards with Applicable National Standards on Consumer/Customer Safety Started Life Cycle Assessment Studies for some Products	Established Programmes for more Streamlined and more Sustainable Operational Processes (E-Green Management Initiatives, Digitalisation of Documents)	Established Products using Hydro and Solar Technology Established Green Supply Chain Management Policy Adherence to EU norms for Waste Reduction
Principle 3	Human Resources Measures: Physical Safety Security, Medical/Retirement Benefits, Mental/ Physical Well Being Measures, Diversity, Gender Issues Learning and Training measures	Grievance Handling Mechanism Human Resources Measures (Encouraging Work-Life Balance, Indicate Safety Governance Structure) Learning and Training Measures Sexual Harassment and Affirmative Action Policies	Training and Skill Development Measures Work Environment in line with Health and Safety Standards	Employee Grievance Mechanisms ASHI Anti-Sexual-Harassment-Initiative Sabbatical policy for Community Service Training and Skill Development Programmes Women Advancement Policies	Annual Safety Awards Manufacturing Unites OHSAS Certified or Process Certification Talent Management Strategy Regular Training on EH&S Adherence to Labour Legislations

	Wipro	TATA Steel	ITC	Infosys	Mahindra
Principle 4	Human Resources Measures: Physical Safety Security, Medical/Retirement Benefits, Mental/ Physical Well Being Measures, Diversity, Gender Issues Learning and Training measures	Engagement and Communication with Different Stakeholders	Various initiatives for Empowering Rural Areas Women's Empowerment Programmes	Different initiatives to involve potential stakeholders (Rural Students, Engineering Collages) Established Infosys Foundation and Infosys Science Foundation	Channelised Stakeholder Engagement Strategy and Regular Stakeholder Sessions Special Channels for Empowering Communities
Principle 5		Access to Ethics Counselor for all Employees, Forum for Women's Empowerment, Clause on Child Labour Commitment to UN Global Compact Self Help Groups (SHG) Distinct Sponsorships for Students, Meal Schemes for Government Schools	Commitment to the UN Universal Declaration on Human Rights and the ILO's Fundamental Human Right Conventions	Repeat of initiatives already mentioned in Principles 1 and 3 Outlined Initiatives for Improving Personal Wellbeing (Annual Employee Satisfaction Survey, HR Policies like Paid Maternity Leave)	M+M Signed UN Global Compact Commitment to National Human Rights Commission, UN Universal Declaration of Human Rights, ILO Convention Grievance Redressal Mechanism
Principle 6	GHG Accounting for Scope 1,2,3 Energy Efficiency, Water Conservation, Biodiversity Initiatives, Reducing Waste through Recycling ISO Certified Environment Management System	Water conservation Adopting green technologies Roadmap for reducing GHG emissions Dissemination of Environmental Performance Reports to statutory bodies ISO Certified Environment Management System	Measures for Reducing GHG Emissions, Water Conservation, Recycling Energy Efficiency Measures	ISO Certified Environment Management System Energy Efficiency measures Water Sustainability Strategy	Carbon Footprint Mapping Environmental Performance Management and Monitoring
Principle 7	Stakeholder identification (Governmental Bodies, Industry Networks, NGOs) Plan for Intensifying Public Policy Advocacy	Stakeholder Consultations (Governmental Bodies, Industry Associations)	Stakeholder Consultations (Governmental Bodies, Industry Associations) Establishing the CII-ITC Centre of Excellence	Board Members associated with UN Global Compact, Business Action for Sustainable Development, World Economic Forum for advocating best practices	Active involvement in public policy through UN Global Compact and with Industry Associations, CII, FICCI

	Wipro	TATA Steel	ITC	Infosys	Mahindra
Principle 8	Programmes in Education and Community Care (Access to Education, Primary Health Care Services, Restoration of Environment, Disaster Rehabilitation, Employee Engagement Measures)	Increased Investing in Different Social Initiatives Applying HDI for Assessing the company's Interventions in Rural Areas	Partnering with State Governments for Watershed Development programmes	Social Security Programmes Financial Inclusion solutions	Different Social Initiatives for the Underprivileged
Principle 9	(combined with Principle 2)	Value Creation Process Established Educating customers		Increased customer engagement through Customer Satisfaction Survey (CSAT) and Engagement-Level Feedback (ELF), Infosys WalletEdge Platform for Financial Transactions	Defined Processes for Customer Feedback

*Qualitative Response

4.5 Energy Use and Environmental Impact Disclosures

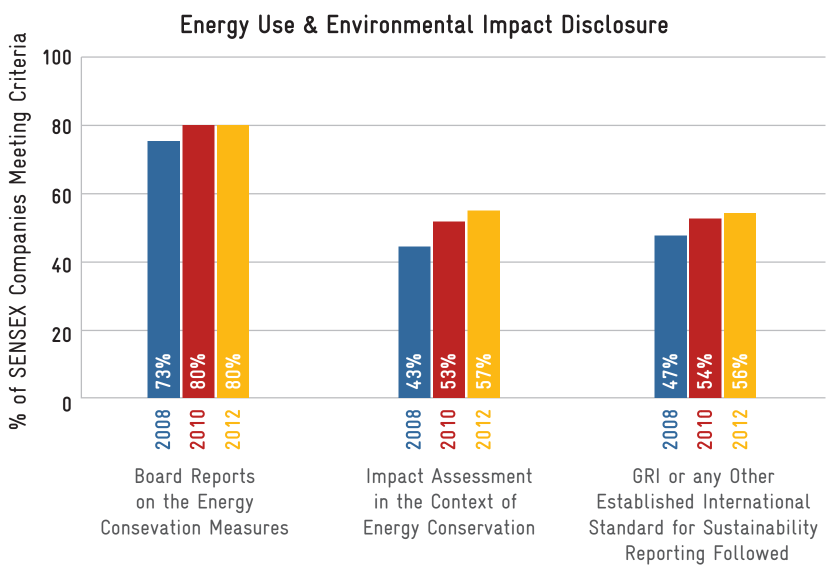
This subsection investigates disclosure responses to three parameters. They are as follows:

#	Parameter	Derived from Regulation /Policy Guidance	Further Context
1	**Board Reports on Energy Conservation Measures** (Mandatory)	A sub clause inserted by the Companies (Amendment) Act, 1988 w.e.f. 1-4-1989 in Section 217 of the Companies Act, 1956 states that the "there shall be attached to every balance sheet laid before a company in general meeting, a report by its Board of Directors, with respect to...(e) the conservation of energy, technology absorption, foreign exchange earnings and outgo, in such manner as may be prescribed."	The Companies Bill, 2011 states the equivalent regulation on disclosures by the Board in Section 134. Moreover, in Section 581ZA of the Companies Act, 1956, it is mandated that at every AGM, every "Producer Company" should present "the audited balance-sheet and profit and loss accounts of the Producer Company and its subsidiary, if any, together with a report of the Board of Directors of such Company with respect to... (vi) any other matter of importance relating to energy conservation, environmental protection, expenditure or earnings in foreign exchanges."
2	**Impact Assessment in the Context of Energy Conservation** (Voluntary)	This parameter is an extension of the mandatory parameter (1) outlined above. While impact assessment is purely voluntary in nature, energy conservation without impact assessment and implications transparently outlined to all stakeholders is considered as an incomplete disclosure for the purpose of this analysis.	Principle 6 of the NVGs of the Ministry of Corporate Affairs states that" the Business should respect, protect, and make efforts to restore the environment" and that one of the core elements of this Principle is that "Businesses should report their environmental performance, including the assessment of potential environmental risks associated with their operations, to the stakeholders in a fair and transparent manner."

#	Parameter	Derived from Regulation /Policy Guidance	Further Context
3	**Form A Disclosure for Energy Intensive Industrial Segments** (Mandatory)	Under the Companies Act, 1956, the "Companies (Disclosure of Particulars in the Report of Board of Directors) Rules, 1988" prescribe a particular format for "Disclosure of Particulars with respect to Conservation of Energy". There are 21 industry segments such as steel, cement, textiles, fertilisers etc (energy intensive industries) that are mandated to disclose particulars as per the prescribed format.	Under the prevalent disclosures format mandated by the Ministry of Corporate Affairs, listed companies disclose their power and fuel consumption data only for their main business entity. However, these companies can comprise a host of subsidiaries taking part in varied business activities and thereby, resulting in a varying level of energy consumption. Therefore, it's a challenge for stakeholders to accurately estimate the emissions of these companies on a consolidated basis.

In the global environment an increasing policy driven impetus for improved disclosure performance by companies owing to the broad scale impact of climate change is witnessed – the spotlight is especially on companies within the energy intensive sectors of economies. This has led to various voluntary disclosure initiatives as an attempt by industries and businesses to restrict disruptive policy regime changes.

Regulatory and disclosure norms with regards to energy and fuel consumption in India have a relatively solid base and it would be instructive for the policy regime as well as industry stakeholders to enhance, improve and to adopt a quantitative performance-based approach as well to go beyond box ticking. Various countries are in different stages of readiness and evolution of this practice. While some of the developed countries like Australia have gone ahead and initiated GHG inventory



reporting from companies, others in the developing world, like Brazil are still in the process of consensus building to introduce similar laws.

The reporting patterns across 2008-12 reflect a dismal picture in terms of both mandatory and voluntary compliance[xv]. While reporting by the Board on energy conservation has remained steadily on the higher end of the spectrum in terms on compliance, impact assessments and reporting on energy use through Form A for disclosures remains low . The levels of compliance on energy disclosures is also revealing of the prioritisation by companies on various material issues of significance, albeit disclosure performance shows a marked improvement over the four-year assessment period.

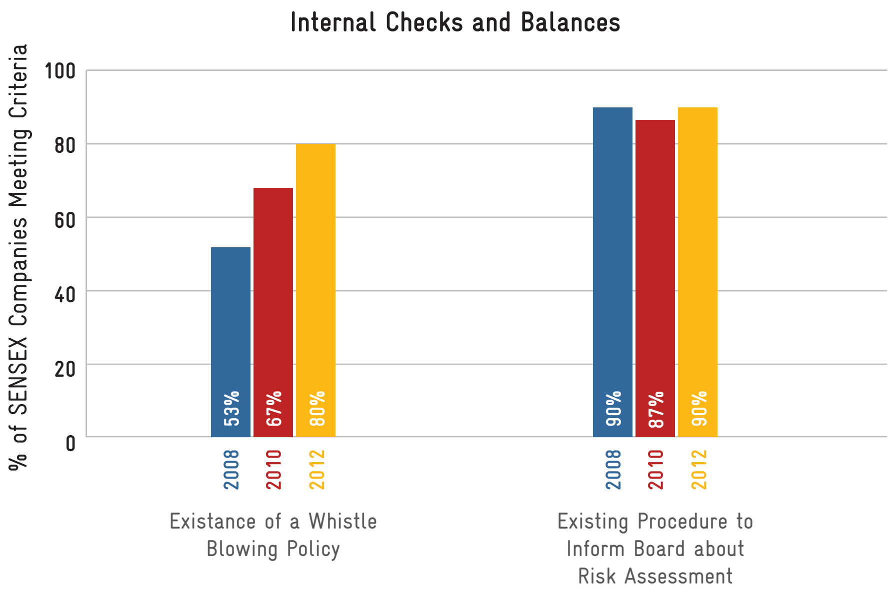
4.6 Internal Checks and Balances

This subsection investigates disclosure responses to three parameters. They are as follows:

#	Parameter	Derived from Regulation/Policy Guidance	Further Context
1	**Existence of a Whistle Blower Policy** (Voluntary)	Annexure 1 D, non mandatory requirements of SEBI's Clause 49, states that: "The company may establish a mechanism for employees to report to the management concerns about unethical behaviour, actual or suspected fraud or violation of the company's code of conduct or ethics policy. This mechanism could also provide for adequate safeguards against victimisation of employees who avail of the mechanism and also provide for direct access to the chairman of the Audit committee in exceptional cases. Once established, the existence of the mechanism may be appropriately communicated within the organisation."	According to stakeholder discussion on the Narayana Murthy Committee Report: "The intention of this clause is that management establishes a mechanism for employees to report concerns about unethical behaviour, actual or suspected fraud or violation of the company's code of conduct or ethics policy. The exact details of such a mechanism should be left to each company, through its Board of Directors, to decide but the existence and implementation must be reviewed by the audit committee. The mechanism must have adequate provisions to ensure there is no victimisation of employees who avail of this procedure."
2	**Existing Procedure to Inform Board about Risk Assessment** (Mandatory)	SEBI's Clause 49, Part IV (C) states that: "The company shall lay down procedures to inform Board members about the risk assessment and minimisation procedures. These procedures shall be periodically reviewed to ensure that executive management controls risk through means of a properly defined framework.	The Birla Committee report ascribes the role of the Board in the context of risk assessment as "The Board directs the company, by formulating and reviewing company's policies, strategies, major plans of action, risk policy.... It controls the company and its management by laying down the code of conduct, overseeing the process of disclosure and communications, ensuring that appropriate systems for financial control and reporting and monitoring risk are in place...."

Whistle blower policies help to put in place a mechanism whereby employee protection is de-linked from potential pitfalls of a system of hierarchical/managerial control. It is suggested that whistle blowing policies should have the following components as a minimum : a clear statement that employees who are aware of possible wrongdoing within the organisation have a responsibility to disclose that information to appropriate parties inside the organisation; the designation of specific individuals or groups outside the chain of command as complaint recipients; a guarantee that employees who in good faith disclose perceived wrongdoing to the designated parties inside the organisation will be protected from adverse employment consequences; and the establishment of a fair and impartial investigative process.

The internal controls of a company are crucial to ensuring risk management and oversight, as well as stakeholder protection. Risk assessment disclosure is central to the whole cause of corporate communication which is intended for all stakeholders (existing and potential) to get an informed overview of the risk fundamentals of corporate entities. Many provisions have been implemented in Anglo-Saxon regulatory regimes to promote transparency especially in context to risks faced by companies. There are of course many pertinent questions that arise with regard to such policies including what is the exact requirement for disclosure; what is the risk that is being assessed; how often do stakeholders utilise such information within and outside companies; and how simply is the information portrayed?



The four-year trends show a steady increase in reporting of whistle blowing policies by the companies assessed. Disclosure of information on procedures to inform the Board on Risk Assessment is relatively stable and levels of compliance are high across the time period.

4.7 Compliance Trends Review

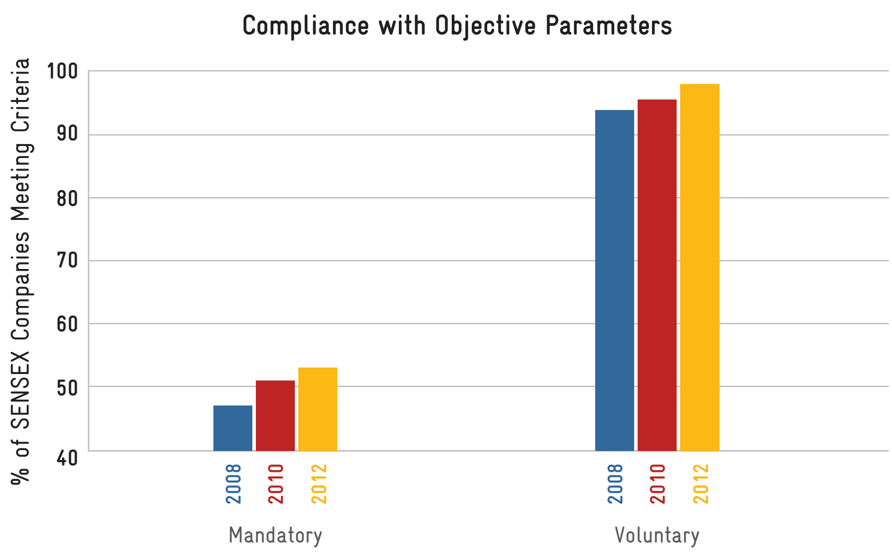
Out of a total of 18 parameters assessed (10 mandatory and 8 voluntary), compliance trends show a marked upturn over the years. Some key trends are:

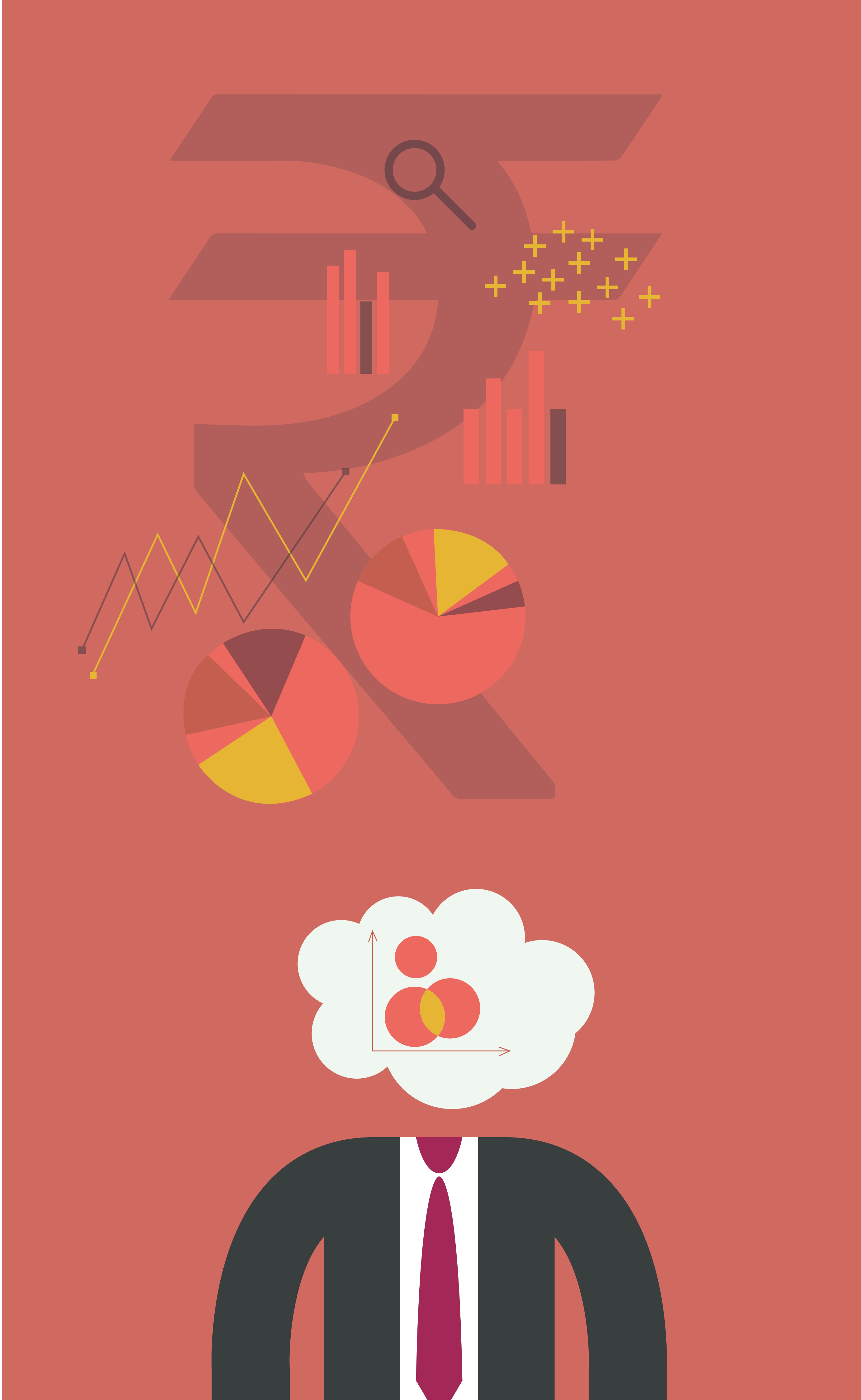
A. While most companies seem to be complying with mandatory provisions, beyond compliance trends on voluntary norms are far from satisfactory levels.

B. The period following the financial crisis saw a large year-on-year change in compliance with both mandatory and voluntary provisions. The events of the financial crisis seem to have made companies more careful about their performance on regulatory adherence.

C. On a more nuanced level, it is interesting to observe that in the case that policy changes seem to be in the offing (through suggestive policy guidelines that may be non mandatory in nature at the outset), the analysed listed companies started to respond to possible changes in the mandatory policy framework as a form of pre-emptive compliance.

D. Furthermore, companies seem to be fairly compliant on mandatory policies around corporate governance such as institution of committees etc, yet when it comes to embedding stakeholder priorities within substantive business operations, performance is dismal.





5

An Objective Assessment of Unlisted Companies

Less than 1% of the total number of companies in the Indian corporate sector are domestic listed companies while the vast majority of more than 6,00,000[xix] companies are private limited and unlisted companies whose shares cannot be bought or sold at stock exchanges within India.

Numbers from 2009 on the largest 300 unlisted companies showed that they were contributing INR 16,782 crore of income and INR 11,974 crore of profit to the country's economy. The Companies Act represents the entire framework for compliance in the case of unlisted companies in India; while listed companies also have to comply with the broader business responsibility regulatory framework as well (NVGs, Clause 49 etc).

Unlisted companies are required to disclose relevant information focused mainly on financial statements, their auditors and their management to the Ministry of Corporate Affairs. Batra (2006), claims that Indian reporting requirements for unlisted companies are "archaic and out of tune".

In the following section, trends of compliance and beyond compliance reporting and practices of unlisted companies will be discussed (see Annexure 3 for the list of companies assessed). The objective of this section is to expand the traditional focus of corporate governance and business responsibility on listed companies. This section will assess how unlisted companies disseminate information on the 18 parameters already described in the previous section. The analyses of the Annual Reports of unlisted companies for this study was conducted for the years of 2008, 2010 and 2011[4].

[4] To find publicly disseminated annual reports for unlisted companies over the three years raised difficulties as the majority of even the largest unlisted companies did not submit annual reports explicitly on their websites. Consequently, the following companies from among the 200 largest unlisted companies have been analysed.

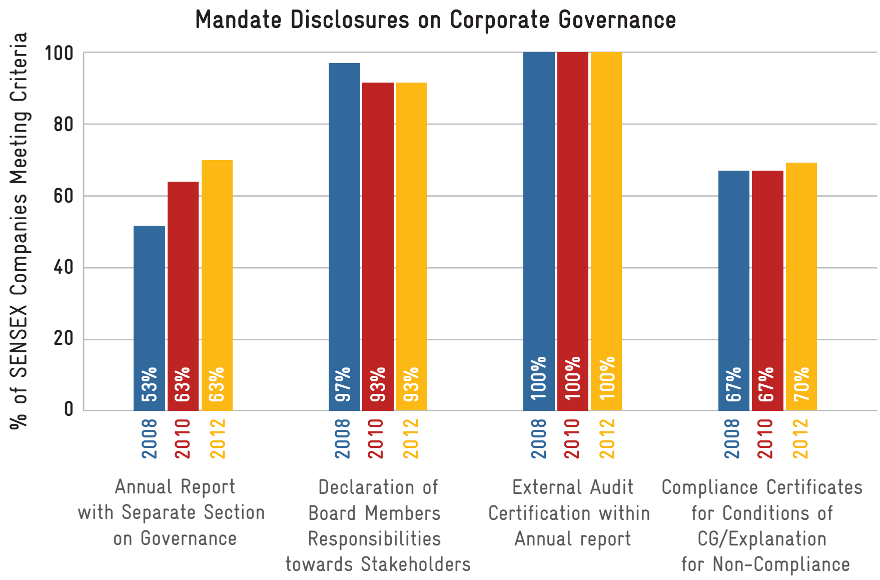
5.1 Mandated Disclosures on Corporate Governance

The Companies Act functions as the legal framework on compliance standards for unlisted companies and the explanation on separate parameters related to the Companies Act is the same as outlined for SENSEX 30 companies. According to the analysis of listed companies the following subsection investigates disclosure responses to four parameters (the classification of mandatory and voluntary are applicable to these companies as outlined below):

Parameters	Listed Companies	Unlisted Companies
Annual Report with Separate Section on Corporate Governance	Mandatory	Voluntary
Declaration of Board Members Responsibilities towards Stakeholders	Mandatory	Mandatory
External Audit Certification within Annual Report	Mandatory	Mandatory
Compliance Certificate for Compliance of Conditions of CG/ Explanation for Non-Compliance	Mandatory	Mandatory

Compared to analysed listed companies which have to comply with all four parameters under this category, unlisted companies don't have to fulfil the two parameters referring to the explicit disclosure on corporate governance. Consequently in the case of the analysed unlisted companies, adherence to the objective parameters is mostly driven by self-regulation.

The proportion of companies submitting a separate Corporate Governance Report and compliance certificates has been increasing over the assessed period and but this still meant that **only two-thirds of the analysed unlisted entities voluntarily**



complied with the disclosure requirements applicable to listed entities. Compliance with the two mandatory parameters is seen in the case of almost all analysed unlisted companies and therefore at a satisfactory level.

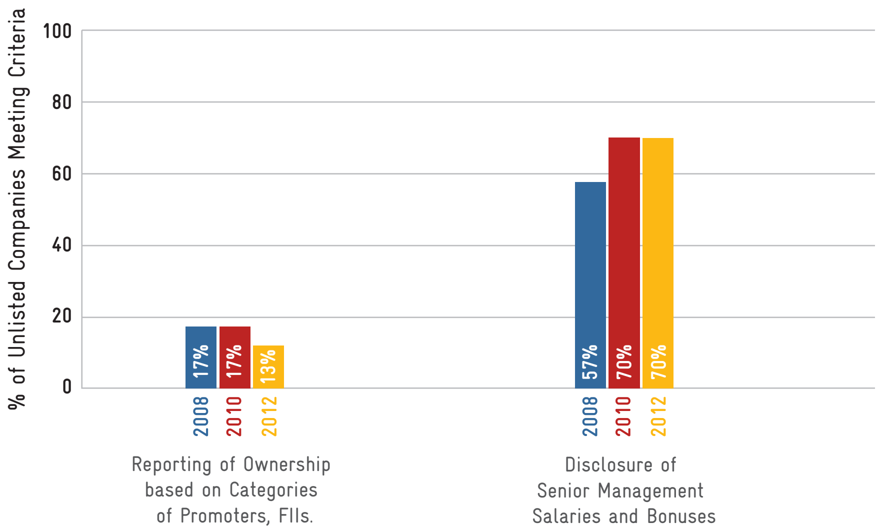
5.2 Ownership and Remuneration

This subsection investigates disclosure responses to two parameters:

Parameters	Listed Companies	Unlisted Companies
Reporting of Ownership based on categories of promoters, FIIs,...	Mandatory	Voluntary
Disclosure of Senior Management Salaries and Bonuses	Mandatory	Voluntary

Both the disclosure requirements under the objective sub categories/parameters assessed on reporting on ownership patterns fall under SEBI's Listing Agreements and therefore not mandatory criteria to be fulfilled by unlisted companies. **Over the three years assessed, only a small number of companies (less than 20%) disclosed information on the distribution of shareholdings among promoters, FIIs etc[5].**

The parameter on the disclosure of senior management salaries and their bonuses in the Corporate Governance Report as outlined in Clause 49 for listed companies is also not binding for unlisted companies. **Notably, compliance of unlisted companies has positively increased over the years 2008 to 2010 (to 70%)** and stagnated at the same level in 2011.



[5] It can be noted that the proportionate number of compliant companies has decreased between 2010 and 2011. As the difference is not significant (only one company) it is assumed that that this is not representative of a larger trend.

5.3 Committees for Enhancing Corporate Governance

This subsection investigates disclosure responses to four parameters. According to the Companies Act of 1956 unlisted companies are only obliged to appoint an Audit Committee responsible:

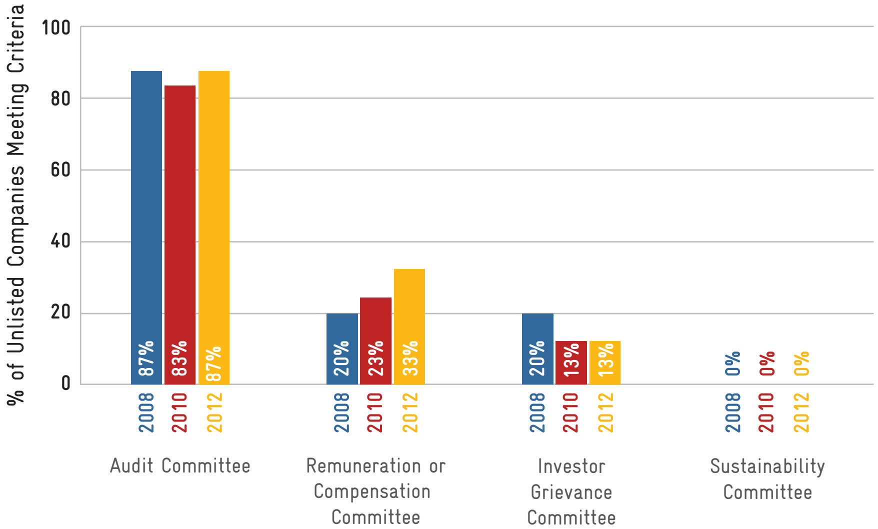
Parameters	Listed Companies	Unlisted Companies
Audit Committee	Mandatory	Mandatory
Remuneration or Compensation Committee	Voluntary	Voluntary
Investor Grievance Committee	Mandatory	Voluntary
Sustainability Committee	Voluntary	Voluntary

According to the Corporate Governance Guidance and Principles for Unlisted Companies in Europe, developed by the European Confederation of Directors' Associations, a not-for-profit association acting as the European voice of board directors, active since March 2005: "A company's committee structure should be proportionate to the needs of the company. However, most large unlisted enterprises are likely to require a nomination committee, remuneration committee, and audit committee. Other committees may be established if required in particular circumstances." Therefore the role of two out of the four analysed parameters according to this benchmark is pivotal to the functioning of even unlisted companies.

There was relatively satisfactory compliance as far as formation of Audit committees, mandated by the Companies Act is concerned, with 87% of the companies assessed complying in 2011. With SEBI's Clause 49 the appointment of an Investor Grievance Committee is mandatory for listed companies and only a small proportion (13% in 2011) of the selected unlisted companies constituted such a committee. **Surprisingly, at the same time even though the establishment of a Remuneration/Compensation Committee is voluntary even for listed entities, the numbers of unlisted companies mandating such a committee have been increasing from 20% in 2008 to 33% in 2011.**

The policy suggestion of the NVGs from the Ministry of Corporate Affairs on the appointment of a sustainability committee was not adopted by any of the unlisted entities. It may be noted that the policy suggestions are relatively nascent and that even in the case of listed counterparts, only two SENSEX companies appointed such a committee.

Existence of Various Governance Committees



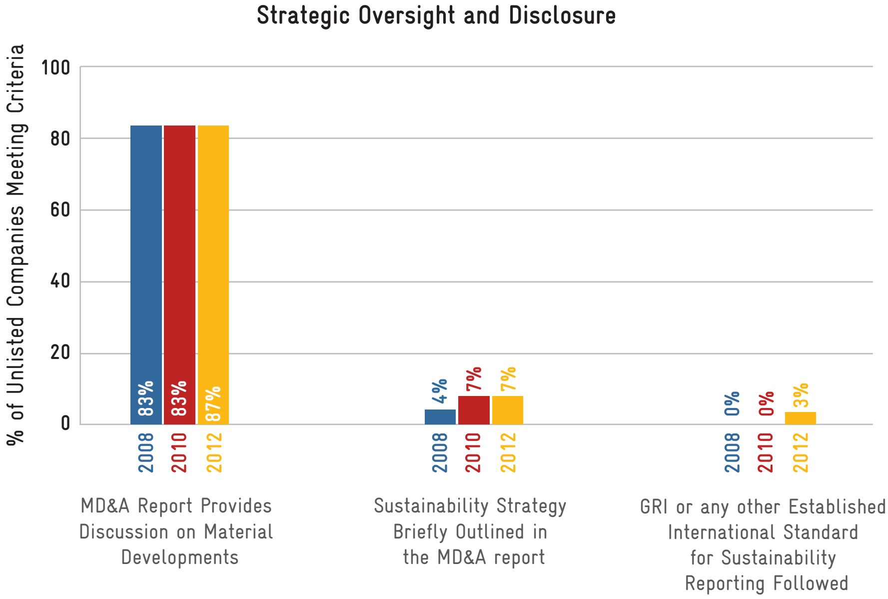
5.4 Strategic Oversight and Disclosure

This subsection investigates disclosure responses to three parameters. They are as follows:

Parameters	Listed Companies	Unlisted Companies
MD&A Report Provides Discussion on Material Developments	Mandatory	Voluntary
Sustainability Strategy Briefly Outlined in the MD&A report	Voluntary	Voluntary
GRI or any Other Established International Standard for Sustainability Reporting Followed	Mandatory	Voluntary

The disclosure on material development and human resources is mandated by SEBI's Clause 49 Listing Agreements and therefore not applicable to unlisted companies. **Consequently, compliance of unlisted companies in terms of providing some discussion on material issues (the substantive-ness of these declarations is not assessed here) was seen to be at a relatively satisfactorily and consistently high level of 83% over the assessed period.**

At the same time, compared to listed companies, unlisted companies show below par performance against the other two parameters which concern business responsibility. While the disclosure of a sustainability strategy has become slightly more common in the analysed group, increasing from 3% to 7%, only one company in 2011 published a separate report on sustainability following the Global Reporting Initiative (GRI) or any other established and internationally recognised reporting standard.

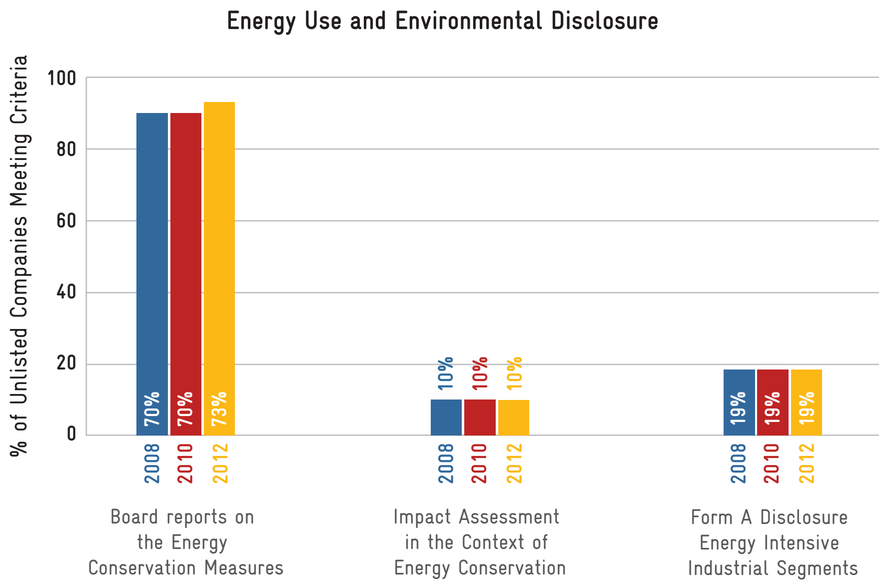


5.5 Energy Use and Environmental Impact Disclosures

This subsection investigates disclosure responses to three parameters. They are as follows:

Parameters	Listed Companies	Unlisted Companies
Board Reports on the Energy Conservation Measures	Mandatory	Mandatory
Impact Assessment in the Context of Energy Conservation	Voluntary	Voluntary
Form A Disclosure for Energy Intensive Industrial Segments	Mandatory	Mandatory

The growing awareness for energy and environmental issues around the world was reflected in the Indian legislation by the addition of a sub clause to the amended Companies Act in 1988, binding companies to detailing their energy conservation measures. **The SENSEX companies analysed in the previous section demonstrated slightly higher compliance rates with 73% in 2008 and 80% in 2012, compared to the unlisted companies with 70% in 2008 and 73% in 2011.** Simultaneously since impact assessment of implemented energy conservation initiatives is not mandatory for Indian companies, a marginal proportion – 10% of unlisted companies disclosed any impact assessment.



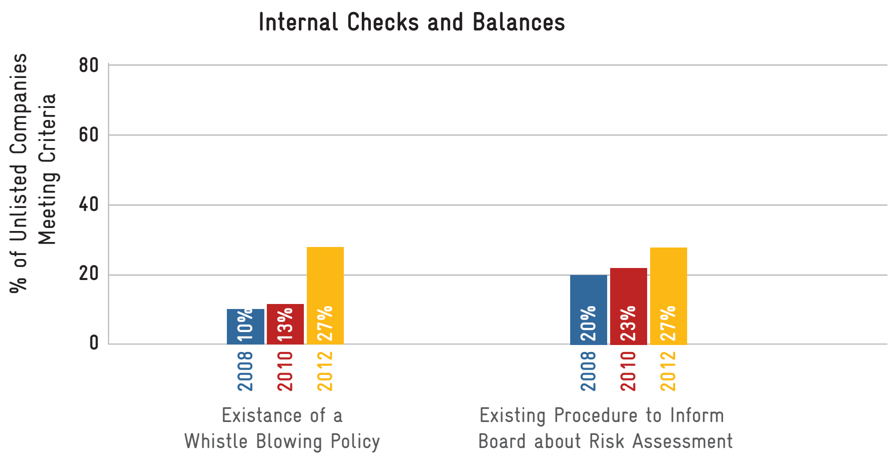
It has to be mentioned that impact assessment statements differed in terms of specification and complexity and that some companies fulfilled that parameter following apparently a "ticking-the-box" attitude. Reporting on Energy Intensive Industrial Segments in Form A binding by the Companies Act was at an unsatisfactorily low level (at 19%) among unlisted companies.

5.6 Internal Checks and Balances

This subsection investigates disclosure responses to two parameters. They are as follows:

Parameters	Listed Companies	Unlisted Companies
Existence of a Whistle Blowing Policy	Voluntary	Voluntary
Existing Procedure to Inform Board about Risk Assessment	Mandatory	Voluntary

Both parameters are mandated by SEBI's Clause 49 and are only mandatory for



listed entities. **The trend of implementing a Whistle Blowing Policy by unlisted companies in order to strengthen employee (a key stakeholder in any company) protection has seen a rise over the assessed period to from 10% in 2008 to 27% in 2011. The same overall proportion of voluntary compliance to outlining risk management procedures was achieved by unlisted companies in 2011.**

In comparison to their listed competitors which achieved high compliance standards (80%) in terms of voluntarily adopting Whistle Blower Policies and (90%) of implementing risk management frameworks, the self-regulation performance of unlisted companies for establishing internal controls is lagging.

5.7 Compliance Trends Review

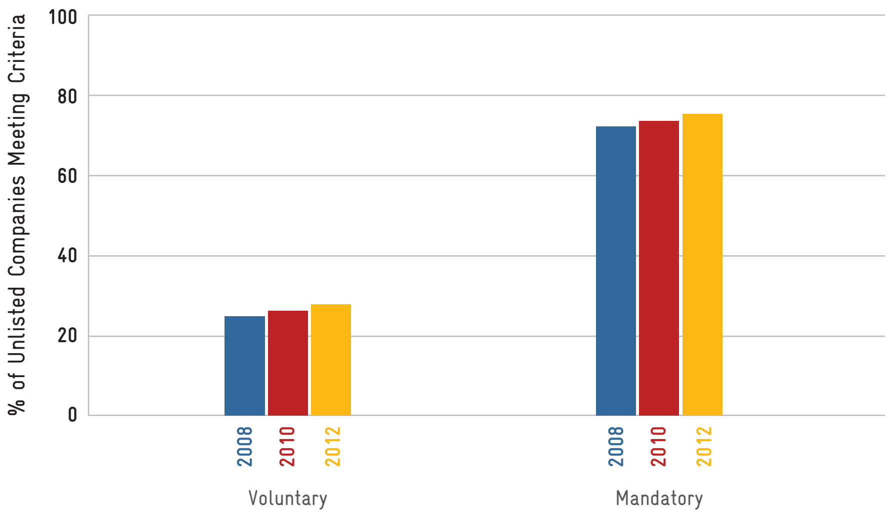
Out of a total of 18 parameters assessed (six mandatory and 12 voluntary) for unlisted companies, compliance trends are almost stagnant around the same level with only a minimal increase of 2% across the analysed period. While the majority of around 75% (2011) of unlisted companies seem to be complying with mandatory criteria, beyond compliance trends are extremely low and fluctuating below the 30% level. Some key observations are:

a. The cleavage between adherence to parameters around corporate governance and business responsibility is large. Business responsibility which can be measured to some extent by compliance to voluntary norms is also clearly less of a priority than for listed companies.

b. Transparency about promoter ownership does not come as naturally to such companies as disclosure of remuneration data. While the reasons for this can be varied, it is certain that there is a difference in adherence to regulations of relatively similar nature.

c. It is also useful to note that disclosure of energy consumption data has been almost comparable to the SENSEX companies (unlike most of the other trends). The fact that companies are reporting on energy conservation means that they have processes and systems in place to implement energy conservation as well as reporting on the issue.

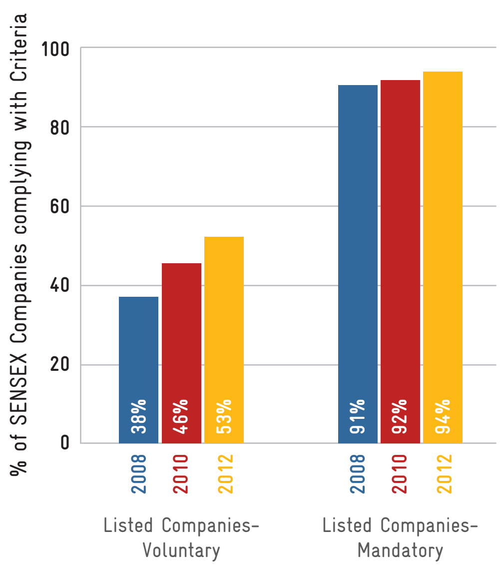
Compliance with Objrctive Parameters

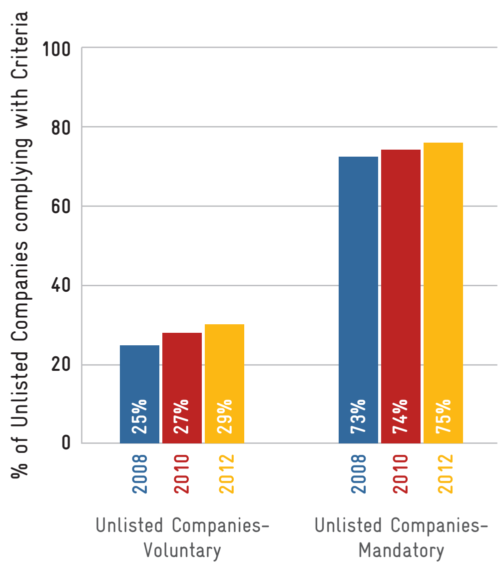


5.8 Compliance Trends: Comparison of Listed and Unlisted Companies

Corporate governance and business responsibility standards for unlisted companies are still at a nascent stage. While most of the SENSEX companies complied with the mandatory parameters selected (94% in 2012) - only 75% of the unlisted entities showed their compliance with mandatory regulations.

While assessing unlisted companies fulfilling objective parameters derived from voluntary regulations/policy suggestions, **it was found that in 2011, around 29% of unlisted companies adopted/adhered to voluntary norms, while in the case of SENSEX companies beyond compliance trends have been positive, increasing from 38% to 53%.**





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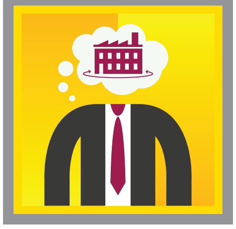


An Objective Assessment of Unlisted Companies

This section presents qualitatively analysis some of the key themes that have been discussed over the course of stakeholder surveys with some of the largest listed corporate entities; eminent legal and auditors based in India. While the questions asked largely followed the survey script, in most cases they had to be suitably modified to fit context and keep the flow between one answer and the next.

The thematic breakdown is as follows: promoter dominated businesses and the impact on corporate governance; the roles and responsibilities of independent directors; stakeholder incentives and protection – employees, communities and investors; sustainability and CSR; navigating the policy paradigm – inputs on voluntary and mandatory policies. Within each of these themes, main qualitative inputs have been highlighted here.

6.1 Promoter Dominated Businesses and the Impact on Corporate Governance

As discussed earlier in this report, the phenomenon of promoter dominated businesses is widely prevalent in India. A number of listed stakeholders were surveyed on this subject and the primary inputs that emerged are discussed here.

The survey questions that dealt with this commonly encountered theme included: What is the structure of promoter ownership? What are the prominent characteristics of the corporate governance model in the context of the business (eg. value system)? What are the key features (eg. interaction between Board and Executives) that have driven the business? Can they be preserved under any other structure of ownership?

6.11 Most of the stakeholders noted that the impact of different ownership structures on corporate governance or business responsibility, is not always similar and the impact varies across sectors. In particular, many of the surveyed stakeholders noted that in the case of the service sector, professionalism in the structure of corporate governance (for promoter dominated companies) is easier to achieve than for sectors such as manufacturing.

6.12 Some companies surveyed, with successful business forays in multiple sectors, remained agnostic to the effects of promoter dominated shareholding and any substantive effects on corporate governance or business responsibility. Notably, in many such cases, the chairman of the Board was also the largest shareholder, with significant control over the business, especially at the strategic decision-making level.

6.13 **A consistent response especially among the companies with diversified business models was that dominant promoter ownership enables/streamlines strategic decision-making process especially in the context of risk taking.** Some of the stakeholders also stated that in the case of decision-making deadlocks at the level of the Board, dominant promoter ownership significantly enabled consensus.

6.14 Another instructive response offered by surveyed companies with promoter dominant ownership was that in the case of risk-taking as outlined here, was that the largest risk always accrues to the largest shareholder. In this way, shareholder protection is not just an exogenous priority from the point of view of strategic decision-making.

6.2 The Roles and Responsibilities of Independent Directors

The Satyam Scandal discussed earlier in this report, provoked significant public attention towards the roles and responsibilities of independent directors. According to industry estimates, around 620 independent directors resigned from Boards of Indian companies in 2009 following the scandal (various reasons including possible anticipation of increased liability/perceived increase in prosecution risks have been ascribed to this unprecedented exodus from the Boards of various companies).

Broadly, independent directors in the case of listed companies are meant to fulfil two roles: that of oversight on behalf of public shareholders and providing strategic guidance to the business operations. Some of the questions that dealt with such themes in the target survey included: *Are there executive sessions held by independent directors for strategic planning? What is the level of accountability?*

What are the other roles and responsibilities of these directors, especially in the context of long term business sustainability?

6.21 Some stakeholders stressed that independent directors are meant to represent shareholder interests but cannot always play a supervisory oversight role over promoters and management and it is unreasonable to expect them to do so. This is owing to various considerations including lack of time availability of such directors who are essentially part time affiliates of the companies. It can be noted that a recent OECD report on Risk Management and Corporate Governance, stresses that the concept of full time non-executive directors should be explored given a similar context.

6.22 In terms of regulations and compliance, some stakeholders pointed out that Clause 49 of the Listing Agreements as prescribed by SEBI is hinged to an extent on the theme of independent directors. In turn, violations of the listing agreements between stock exchanges can result in a de-listing of companies (in the most severe of cases), and can result in both financial penalties and criminal sanctions under the Securities Contract (Regulation) Act, 1956. Therefore, the element of liability is sufficiently high, and adherence to corporate governance rules pertaining to independent directors in Clause 49, is almost by default. At the same time, stakeholders observed that they had not come across many instances of stock exchanges de-listing companies or taking financial/criminal action through SEBI for the violation of Clause 49 regulations. **Therefore regulatory liability did not seem to be the only factor driving compliance – indeed enforcement is a big factor.**

6.23 Some of the surveyed stakeholders illustrated examples of strategic decision-making by independent directors. Particularly in the case of companies with highly technical business segments, independent directors seem to play a relatively more prominent decision-making role. **In the case that the surveyed stakeholders were independent directors, they highlighted that playing a strategic advisory role is what they see as their foremost objective rather than an oversight role.**

6.24 **Almost unanimously, the corporate executives and Board members surveyed alluded to the corporate governance regulations that deal with structural composition (eg. number of independent directors on the Board as a percentage of total etc) listed in Clause 49 being important for good corporate governance or business performance**

in more generic terms, only to a limited extent. (Drawing from international examples such as Enron, which had only two inside directors, it can be noted that it might be hard to empirically find any correlations between the number of independent directors on the Board of companies and corporate governance performance. This aspect deserves further study in the Indian context.)

6.25 Anecdotal examples shared during the surveys included examples of Board members (aside from the chairman) being most effective in the oversight process, when unanimous decisions were reviewed in depth due to lone dissenters. However, no feedback was offered on whether such dissentions are more likely to come from independent directors as representatives/guardians of public/investor interests or from any of the other non-executive or executive directors.

6.26 One fairly uniform response that was noted in the context of the importance of independent directors on Boards of large companies with multiple stakeholder interests was that **formulaic approaches to structural composition of Boards lack the substance to change corporate behaviour.** In the same vein, various stakeholders pointed out that effective corporate governance at the level of the Board often stems from relationships, mutual trust and understanding between Board members and business responsibility from a good grasp and strategic overview of business segments and operations.

6.27 Some of the surveyed stakeholders emphasised ensuring efficient and compliant processes (for instance of internal audits) rather than overseeing the technical aspects of company operations as being more central to the work done by both non-executive directors and executive directors.

6.3 Audit Committees, Internal and External Control

Generally, Audit Committees are seen by policy makers as central to internal oversight along with the other elements of business responsibility that lead to better internal and external control measures being employed by companies. Some of the questions that helped the surveyors to get to the bottom of the qualitative and substantive issues around the role of such committees, internal and external control included: *How often does the Audit Committee/Board interact with external auditors regarding internal control systems, scope of audit and annual financial disclosures? How is the external auditor appointed (must be at AGM) and how is it ensured that the independence of the auditor is maintained?*

6.31 Most of the companies surveyed noted that external auditors and Audit Committees worked in close coordination on audit issues. Some pointed out, that external auditors were invited to all Audit Committee meetings held by their companies. **There was broad across the spectrum agreement that the role of the Audit Committee and the interactions with external auditors are central to the audit process of all stakeholders.**

6.32 All of the surveyed companies claimed that their external auditors were appointed at their Annual General Meetings (AGMs). This is in convergence with mandatory policy guidelines and follows from global best practice. However, it was also noted that there is generally no debate around such issues at AGMs. **Shareholders are not often interested in the selection criteria, and even more so in case the selected auditing firm is suitable large and well known.** The reputation advantage is strong, and a good reputation tends to win favour with all company stakeholders.

6.33 Interesting perspectives were received on the issue of auditor independence. Some companies claimed that auditor independence was maintained through strictly professional relationships. **Others pointed out that auditor independence is not just the mandate of companies employing audit firms, but also of the audit firms themselves.** (Over the last few years a number of issues around corporate governance have caused increasing scrutiny of auditors. Therefore, the large auditors that service the companies surveyed, tend to have their own checks and balances for ensuring independence. The role of the sector regulation in the context of audit firms is important in this regard.)

6.34 **It was often pointed out that the role of auditors is secondary to the internal controls in place.** To substantiate this claim, some companies pointed to the vast volumes of audit data that must be carefully scrutinised by audit firms – a process for which they are held legally liable. However, owing to the vast volumes of data that must be processed as in the case of the large listed companies surveyed here, it is not possible for auditors to verify all facts with equal emphasis. This concern about expectations from external auditors being stretched or overemphasised in the regulatory paradigm is commonly expressed even in corporate governance literature. The fact that the quantities of data are simply too vast to go through wholly, implies that sampling plays a key role in the audit process.

The amount of reliance placed on the work done by external auditors requires further study in the Indian regulatory context.

6.35 **Surveyed stakeholders expressed concern about the mandatory rotation of external auditors being considered central (for instance the Companies Bill, 2011) to the issue of audit accountability.** Stakeholders cited various reasons, including that this method of ensuring responsible corporate governance was akin to regulations on the composition of the Board (such as the percentage of independent directors) and moreover, since the companies surveyed were among the largest in the country, they would appoint the same group of audit firms of commensurate size; also that the mandate of the Audit Committee is to ensure independence from external auditor and therefore they should be more than qualified to suggest in case there is a change required and so on.

6.36 Many of the companies surveyed indicated that regulatory oversight should be firmer on the audit firms so that increased liability results in more careful external audits. In turn, companies agreed that the additional manpower and cost implications would indeed have to be borne by themselves.

6.37 The companies surveyed also indicated that the large audit companies themselves can informally communicate with each other to bid to audit each others' existing clients in a veritable quid pro quo. **Therefore relatively smaller, independent firms rarely would get an opportunity to make a realistic entry into the auditing of the largest 100 companies in India.**

6.4 Stakeholder Incentives and Protection – Employees and Investors

Whistle-blowing provisions were first introduced in the US with the Sarbanes-Oxley Act (SOX) in 2002. Listed companies on the US stock market are supposed to have some system for internal reporting. SOX does not however mandate the use of particular reporting channels. In the Indian context, formal Whistle Blowing Policies are seldom disclosed and more often than not facilitated through informal channels. Similarly, the role of an ethics policy is not fully understood in the institutional context. Meanwhile the perception by the companies of their investors varies tremendously according to the size and nature of investments. Most companies once again employ informal channels of communication to keep the information flow and feedback process sufficiently robust.

Some of the questions dealing with such issues in the survey included: *What is the Board's role in preserving ethical conduct? Is there an Ethics Committee/ Subcommittee? Is there a Whistle Blowing Policy – and if so is this a useful tool – why or why not? Is there a Nominations Committee in place? How are investor's priorities integrated with the business model? What is the existing mechanism for facilitation of ownership rights of all stakeholders including institutional investors? What are the performance enhancement mechanisms for active stakeholder (employee) participation in achieving strategic priorities?*

6.41 Most companies surveyed did not have an explicitly outlined ethics policy or an existing Ethics Committee. **The companies claimed that ethics policies, were more often than not contained (not necessarily in a directly recognisable form) within their HR policies.** Non-existence of Ethics Committees was at times attributed to a similar paradigm of engaging with employees through one channel instead of creating parallel channels undermining the effectiveness of HR operations.

6.42 **Ethics policies, when in place, were attributed to the requirement to adhere to international norms/sector trends rather than to government or private sector policy prescriptions.** Therefore, companies with an international presence or international clients or international investors, felt compelled to put in place ethics policies and more holistic HR policies to align themselves appropriately.

6.43 Most companies had Whistle Blowing policies in place. All of them alluded to examples such as Enron as the turning point for rethinking the importance of such policies for ensuring a robust internal control mechanism. **Companies that are operating within sectors where internal controls are particularly important (such as the banking sector), all pointed towards the sector emphasis on Whistle Blowing being a useful self-regulation tool.** However, none of the companies shared details on the number of reported cases/incidents with their shareholders or on how the reports were handled.

6.44 Not all the companies surveyed had formally defined Nominations Committees in place for appointment of senior executives or Board members.

Some had allocated the role of such committees to other committees such as Corporate Governance Committees. In other cases, the Corporate Governance and Nominations Committees had overlapping roles and were both authorised to look into matters concerning appointment/merit based assessment of senior executives and Board members.

6.45 Some companies claimed that in practice the search for new directors was often outsourced to head-hunters. This was not seen to be a uniform response across sectors but was common in the case of sectors where particular skill sets required were highly technical and there was a need gap that needed to be filled (by say appointment of a non-executive Director with the right mix of competencies and experience).

6.46 In all surveyed companies, Nominations Committees comprised both non-executive directors and executive directors.

6.47 In order to better accommodate large institutional shareholders some of the surveyed companies had given Board membership to representatives of such institutions. Therefore according to the companies that adopt this practice, either in an executive or non-executive capacity, large institutional investors are assured of their inclusion in strategic decision-making.

6.48 The companies surveyed in the banking sector in particular, which is regulated by the Reserve Bank of India (RBI), have a number of parallel channels for interfacing with institutional investors including direct channels of communication with strategy or investor relations teams. Such teams generally propose strategic direction to large investor for medium to long-term horizons. **Once again, owing to the special structure of regulations around the sector, as well as the operational and strategic requirements inherent to the sector, investor priorities were treated with commensurate internal prioritisation.** This amount of democratisation was not reflected across sectors, and the common reason given was that the discretionary element of strategy is important, and receiving a buy-in from all large shareholders on strategic business decisions is not necessarily efficient and indeed time delays were often cited concerns.

6.49 Many companies cited both Board level and manager level training and awareness programmes around various sub themes under the aegis of corporate governance. **However, there were no instances of impact assessment of such programmes in evaluating their effectiveness.**

6.410 Companies cited sitting fees as being the only incentives (in accordance with mandatory regulations) for independent directors aside from reputational benefits. Many also stated that these needed to be revised upwards to offer real incentive to sift through the volumes of data that they were required to in various committees, especially the Audit Committee.

6.5 Sustainability and CSR

Both sustainability and CSR are relatively new entrants as concepts into the Indian regulatory and business sphere. While groups such as the Tatas have been involved in philanthropic activities over a long period of time, CSR or engagements with communities or even long-term sustainability of the business and the business environment are not inherent in every company. This is where the role of regulation comes in, to bridge the gaps across the spectrum of business responsibility performance.

Some of the questions dealing with such issues in the survey included: Are there particular concentrations of communities in the areas where business operations are carried out? *Is there an explicitly defined sustainability strategy of the business (with particular focus on engagement with communities in such areas)? If so, how are Board members given access to relevant information that can help them assess the long-term strategic priorities of the business?*

6.51 **Not all companies had an explicitly defined CSR policy. In all cases that CSR policies existed, they were defined according to the operational business segments/sectors.** Therefore in the case of the manufacturing sector or agro-business sector, community engagements were top priorities, whereas in the case of stakeholders operating in the banking sector, financial inclusion, rural banking and financial literacy were given priority.

6.52 Through the surveys it was found that CSR policies are often drafted by a number of different stakeholders/committees within companies in consultation with each other. **The communications, secretarial, sustainability/CSR, Environment, Health and Safety and compliance teams were the usual stakeholders involved in drafting CSR policies.** Therefore the process of drafting the CSR policy is far from uniform – and there were significant differences within sector variations found.

6.53 In the case of one particular stakeholder operating in the FMCG sector, it was pointed out that business operations opened up the social/community interface. The company stressed that such channels of interface in turn created social/community engagement opportunities which enhanced business productivity and the productivity of the supply chain. Therefore according to the stakeholder, CSR is a misnomer as it is not the social responsibility but the business responsibility of companies to engage with all their stakeholders. **The different stakeholders surveyed seemed to be polarised on the definitional aspects underlying the CSR issue. At the same time, they unanimously agreed that one regulated, CSR would indeed become defined as such and implemented in compliance with the regulations in the revised version of the Companies Act (if the associated Bill is passed).**

6.54 Some of the companies pointed out that CSR activities (using the definition applicable as per respective surveyed companies) helped in removing market inefficiencies through direct community engagement. Therefore there is direct correlation with improving the bottomline and improved interface and engagement with communities affected by various business segments. **Sectoral best practices were often cited as benchmarks rather than global best practices in the realm of CSR, since companies take actions based on the logic of competitiveness.** However, this practice of peer review induced learning or awareness through direct interface is not often replicated in sectors where market inefficiencies (middleman syndrome for instance) are not major drivers.

6.55 **Some companies pointed out that the process of sustainability, MD&A or CSR reporting in many instances (since not mandatorily applicable until August 2012), acted as a self-review exercise whereby the learning has been introspective and revealing and has helped to streamline internal operations.** One particular stakeholder pointed out that there was a standard operating procedure in place (elaborate document handed out to managers across business segments) for all data inputs that would generally be used for writing the sustainability, MD&A or CSR reports. This apparently helped in building an objective self-assessment mechanism as well as tailoring new interventions.

6.56 Risk assessment in the case of industrial operations was usually done using established benchmarks, standards and modelling techniques (such as Du Pont Safety Systems). However, as per survey responses, it was rarely the case that a systemic emphasis on resource risks and/or climate change was given. Each issue (for instance the declining availability of particular raw materials) was treated outside of a holistic framework. **Issue based responses seemed to be the norm rather than the exception.**

6.6 Navigating the Policy Paradigm – Inputs on Voluntary and Mandatory Policies, Transparency, Penalties and Accountability

Questions dealing with the many subthemes embedded within this overarching theme received the most varying responses. The perceptions of the mandatory and voluntary policy paradigms are influenced by a number of factors including historical responses (since company representatives cannot take diametrically opposite views to those that are institutionalised based on historical patterns of response and engagement with the policy community, markets etc).

Some of the questions that dealt with the overarching theme in the target survey included: *What is the perception of mandatory and voluntary regulations their impact of business strategy/governance/stakeholder responsibility? What is the perception of policy sticks and carrots in the context of the sector which the business operates within? What is the role of various regulatory and supervisory institutions and what is the level of complementarity?*

6.61 Responses to questions on policies varied significantly. An interesting and perhaps under-documented perspective that emerged concerned the process through which voluntary recommendations or policies would be adopted by companies. In almost all instances, Board members were informed of voluntary regulations through their compliance teams (corporate sectaries etc). **In turn, the reputational risk of not adhering to or seeming to adhere to voluntary prescriptions tends to act as a catalyst for action in terms of Boards accepting normative principles etc.**

6.62 One of the clear trends was that defaulting on Listing Agreements was not seen as a big cause of concern as far as actual liability goes since not many cases of de-listing penalties have been observed in the context of the largest companies. The argument of shareholder protection was also used to clarify reasons for the rarity of maximum penalty imposition by stock exchanges, since in the case of large listed companies, public shareholders would suffer asymmetrically due to de-listing of companies in which they have stakes.

6.63 All surveyed companies highlighted that regulations were an evolutionary process and that prescriptive or disruptive interventions in the regulatory sphere were likely to unbalance a large number of companies. **Inclusion in the policy formulation process was outlined as a clear priority.**

6.64 A few stakeholders noted that compliance to mandatory regulations did not necessarily result in better financial performance or shareholder support. It was pointed out that significant gains (whether monetary or otherwise) are only made when companies are well beyond the compliance framework – therefore exhibiting an edge in their respective sectors/segments as well as a strategic integrity to their different categories of investors.

6.65 Some companies pointed out that the definition of objective data points was a necessary precondition to substantive corporate governance or sustainability reporting. **Therefore, in the case of CSR engagements for instance, the entire exercise of reporting would become more revealing if the operational boundaries as well as the logic and basis for data were well defined through sector specific regulations.** This would also enable companies to align with global best practices while simultaneously enhancing internal controls and making the reporting process efficient at each level (rather than representative of an aggregation of subjective assessments throughout the business chain).

6.66 Regarding the role of multiple institutions, companies often responded that increased coordination was required to make a stronger case for a robust regulatory framework and adherence. **Moreover, institutional oversight through government entities was often perceived to be "designed to increase control" rather than ensure good corporate governance or business responsibility by making a business case.**

Stakeholder Surveys – A Qualitative Analysis of Responses Received

Summary of Findings and Discussion on the Intuitional Regulatory Paradigm

7

Summary of Findings and Discussion on the Institutional Regulatory Paradigm

This study has attempted to provide a discursive overview of corporate governance and business responsibility through a situational analysis of some of the largest companies in India. In this context, it is important to note two evolving trends that must eventually be fully reflected in the Indian regulatory paradigm. First is the now widely-acknowledged fact that corporate governance must be viewed from the prism of stakeholder responsibility as opposed to simply shareholder responsibility.

As seen in this study, the underlying drivers for public disclosures tend to vary considerably depending on the nature of the policy and the perceived benefits that companies see from adhering to the mandatory or non-mandatory regulatory paradigm. Since policies which can be classified as corporate governance norms or business responsibility norms, focus on a number of aspects related not just to the protection of the shareholder by requiring efficient and effective governance and oversight, it is clear that even in the Indian context, the notion of stakeholder responsibility while not often explicitly stated, is embedded within different strands of policies.

Compared with the singular objective of maximising shareholder wealth, adding to stakeholder value is important as businesses and the communities and markets within which they operate, are inherently interlinked. In the context of large companies such as the ones analysed in this report in particular, the impact of business operations is never limited to just the shareholder, and concomitantly, the regulations attempt to address larger stakeholder concerns, albeit in a disaggregated manner.

The shareholder wealth maximisation model is premised on the principal-agent paradigm alluded to earlier in the report. That is, governance rules and process are designed to control managers and other business operations/participants in order to ensure the owner's interests (especially minority shareholders) are protected and facilitated. Meanwhile the stakeholder responsibility discourse focuses on minimising multiple stakeholder risks; and broadens the value created beyond that for shareholders. These distinctions are further outlined in the table below adapted from Ayuso and Argandona (2007).

Table: Distinctions between the Shareholder and Stakeholder Discourse

	Shareholder Perspective	Stakeholder Perspective
Purpose	Maximising shareholder wealth	Maximise stakeholder value (communities, markets etc)
Governance Structure	Principal-agent model (managers are agents of shareholders)	Stakeholder production model
Performance Metrics	Shareholder value sufficient to maintain investor commitment	Fair distribution of value created to maintain commitment of multiple stakeholders
Residual Risk Holder	Shareholders	All stakeholders

The second evolving trend, but one which is not adequately captured through any existing regulatory paradigm anywhere in the world is that of the notion of responsible corporate governance. In India, like in most other places, corporate governance and business responsibility tend to be viewed as being mutually distinct. However, this study shows that the correlation between adherence to corporate governance regulations and business responsibility norms is positive. That is, companies that already have the basic mandatory processes and governance structures in place are more likely to also be the ones that tend to adhere to voluntary norms. Corporate governance and business responsibility are no longer add-ons to markets; they are integral to them. Therefore the regulatory paradigm must view them as part of the same overarching discourse on governance, strategy and accountability and oversight.

Corporate Governance + **Business Responsibility** = **Responsible Corporate Governance**

7.1 The Drivers of Responsible Corporate Governance

A variety of drivers for what can be termed as responsible corporate governance using the aforementioned definition have been identified. These include:

a. **Sector Regulations:** The response to various policies whether mandatory or voluntary, is significantly affected by the sectoral reporting/ response trends. That is, in sectors such as banking or broadcasting, sector specific regulations tend to drive compliance and beyond compliance reporting and processes in the context of regulations applicable to the entire spectrum of large companies.

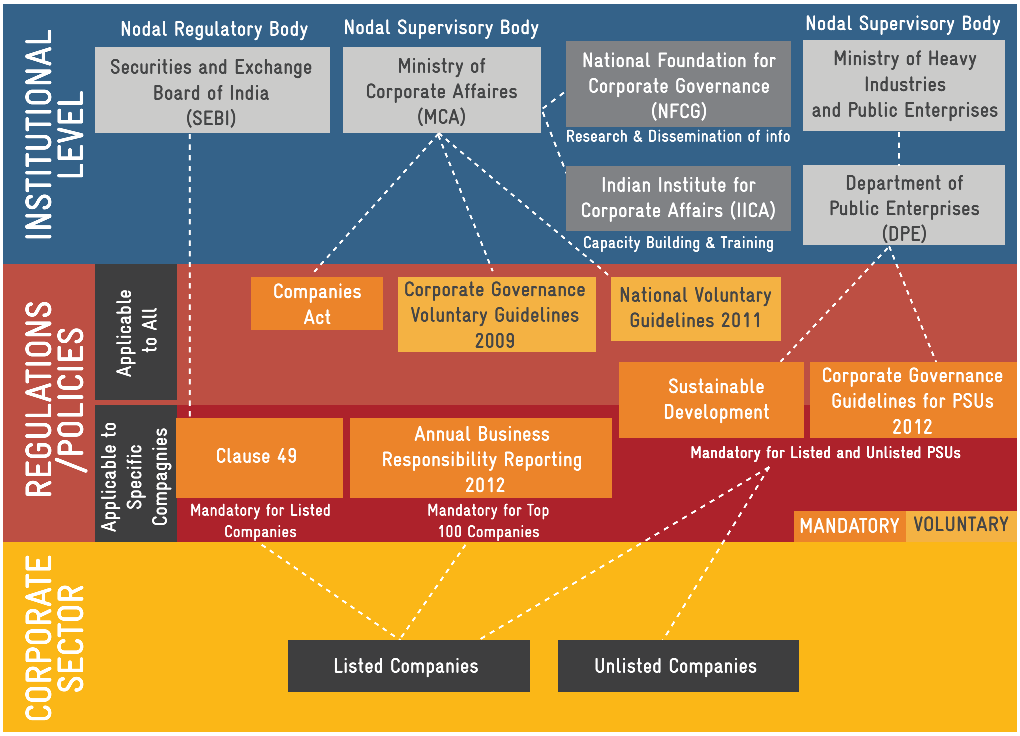
b. **Self Regulation and Global Benchmarks:** In the case of some companies, internal controls are strong for a variety of endogenous reasons. Therefore the exogenous layer of regulations or prescriptive policies functions only as frameworks or guidance for reporting rather than instituting processes for internal controls. This is especially true in the context of companies that strive to reach international benchmarks rather than limit themselves to the domestic regulatory framework.

c. **Peer Review and Competitiveness Concerns:** The first stakeholders to analyse public disclosures of various companies are their sector competitors. This has been confirmed through the surveys conducted in this report and therefore the role of peer review and the motive of staying competitive within the sector are key drivers of adherence to both corporate governance regulations and business responsibility norms applicable to large listed and unlisted entities in India.

7.2 Institutional Oversight and Possible Steps towards Progressive Reforms

There are a number of supervisory and regulatory institutions responsible for the oversight of corporate governance and business responsibility policies in the country. In this context it is important to note that the evolution of such regulations and norms has been organic, rather than supplanted all at once, and therefore policymakers have built upon existing frameworks of oversight which are designed as an overlay to the existing structure. While the natural points of reference (existing institutions) have been pivotal in building a coherent policy framework, the next progressive iteration would necessitate the integration of roles and responsibilities specific to different components embedded within our definition of responsible corporate governance in order to be efficient and effective.

Within the framework outlined in the figure above, there are a few prominent issues that require streamlining. One of them is the oversight on the ABRR, which is essentially a framework for public disclosure developed by MCA. The reporting



has been mandated by the nodal regulatory body of listed corporate entities, SEBI, which is not however responsible for the policy formulation as such. There is also a question of Public Sector Undertakings (PSUs) which are essentially regulated by arguably more stringent corporate governance and business responsibility regulations as the majority stakeholder, the Government of India, is also responsible for the welfare of the State. Therefore, for two companies of equal size, and impact on an array of stakeholders, the PSUs are held accountable through mandatory provisions in policy for both components of responsible corporate governance as outlined here, whereas this is not necessarily the case for private companies, with unlisted private companies being a particularly relevant example where Clause 49 is not applicable, and therefore elements of policy mandated stakeholder responsibility are missing within.

There are other problems of a similar nature as pointed out here where there are either overlaps or divergences in the way that companies are regulated or norms are prescribed. In this context, institutional coordination and cooperation is necessary at the level of the government, in order to foster a more nuanced understanding of the contexts within which companies are operating and the adherence to policy provisions. Moreover, within the same context it can also be noted that the following two issues are central to enabling the responsible corporate governance paradigm in the country:

a. **Comprehensive Impact Assessment:** While there are a number of progressive policies and norms in place, which aim to embed elements of responsible corporate governance within the corporate landscape, there is a minimal provision for impact assessment in the context of benefits to stakeholders. To illustrate, conservation of energy is an instructive example. It has been analysed in this report that assessment of energy conservation impact on stakeholders under certain Companies Act clauses applicable to energy intensive business segments are not adhered to even by the largest listed companies on a substantive basis.

   There is a trend of reporting for the sake of reporting rather than for actually evaluating palpable impact of communities' affected, environmental conditions etc. In order to be effective at the level of the stakeholder, policies have to go beyond the minimal assessment reporting paradigm to a more comprehensive oversight mechanism. Perhaps this could be ensured through existing institutions or a new institution, in either case, a nodal institution for listed, unlisted, private and public companies in order to be able to have a common assessment benchmark, even if there are divergent reporting requirements.

b. **Quasi Regulatory Institutions at the Sectoral Level:** Throughout this study there are numerous examples of companies that are regulated by sector specific regulations. Sometimes the regulatory policy paradigm within which these companies operate necessitates that companies go beyond the overarching policies that govern the larger superset of companies whether listed or unlisted. There are many sectors within which the supply chain is also tightly regulated and therefore the stakeholder implications vary from sectors where only overarching policies such as the ones analysed in this report are applicable.

   Aside from sector specific regulations that impact corporate governance standards, the element of sector/peer review by competitors is also a major driver of responsible corporate governance as mentioned in the previous subsection. Therefore, sector specific institutions must have a larger role to play within the regulatory paradigm than currently assigned. Moreover, there should be a clear linkage visible between sector specific regulatory bodies and nodal bodies that regulate and supervise the corporate sector as a whole.

Annexure 1

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SEBI/CFD/DIL/CG/1/2004/12/10
October 29, 2004

The Managing Director/Executive Director/Administrator of all the Stock Exchanges
Dear Sir/Madam,
Sub: Corporate Governance in listed Companies – Clause 49 of the Listing Agreement

1. All Stock Exchanges are hereby directed to amend the Listing Agreement by replacing the existing Clause 49 of the listing agreement (issued vide circulars dated 21st February, 2000, 9th March 2000, 12th September 2000, 22nd January, 2001, 16th March 2001 and 31st December 2001) with the revised Clause 49 given in Annexure I through I D to this circular. SEBI Circular no. SEBI/MRD/SE/31/2003/26/08 dated August 26, 2003 (which has been since deferred) is hereby withdrawn. The revised Clause 49 also specifies the reporting requirements for a company.

2. Please note that this is a master circular which supersedes all other earlier circulars issued by SEBI on Clause 49 of the Listing Agreement .

3. The provisions of the revised Clause 49 shall be implemented as per the schedule of implementation given below:

a) For entities seeking listing for the first time, at the time of seeking in-principle approval for such listing.
b) For existing listed entities which were required to comply with Clause 49 which is being revised i.e. those having a paid up share capital of Rs. 3 crores and above or net worth of Rs. 25 crores or more at any time in the history of the company, by April 1, 2005.

Companies complying with the provisions of the existing Clause 49 at present (issued vide circulars dated 21st February, 2000, 9th March 2000, 12th

September 2000, 22nd January, 2001 16th March 2001 and 31st December 2001) shall continue to do so till the revised Clause 49 of the Listing Agreement is complied with or till March 31, 2005, whichever is earlier.

4. The companies which are required to comply with the requirements of the revised Clause 49 shall submit a quarterly compliance report to the stock exchanges as per sub Clause VI (ii), of the revised Clause 49, within 15 days from the end of every quarter. The first such report would be submitted for the quarter ending June 30, 2005. The report shall be signed either by the Compliance Officer or the Chief Executive Officer of the company.

5. The revised Clause 49 shall apply to all the listed companies, in accordance with the schedule of implementation given above. However, for other listed entities which are not companies, but body corporate (e.g. private and public sector banks, financial institutions, insurance companies etc.) incorporated under other statutes, the revised Clause 49 will apply to the extent that it does not violate their respective statutes and guidelines or directives issued by the relevant regulatory authorities. The revised Clause 49 is not applicable to Mutual Funds.

6. The Stock Exchanges shall ensure that all provisions of the revised Clause 49 have been complied with by a company seeking listing for the first time, before granting the in-principle approval for such listing. For this purpose, it will be considered satisfactory compliance if such a company has set up its Board and constituted committees such as Audit Committee, Shareholders/ Investors Grievances Committee etc. in accordance with the revised clause before seeking in-principle approval for listing.

7. The Stock Exchanges shall set up a separate monitoring cell with identified personnel to monitor the compliance with the provisions of the revised Clause 49 on corporate governance. The cell, after receiving the quarterly compliance reports from the companies which are required to comply with the requirements of the revised Clause 49, shall submit a consolidated compliance report to SEBI within 60 days from the end of each quarter.

Yours faithfully

Parag Basu

Encl: Annexure I, I A, I B, I C & I D

Annexure 2

Companies Assessed on Sep 10, 2012
NAME
ITC LIMITED
RELIANCE INDUSTRIES LIMITED
INFOSYS LIMITED
HDFC BANK LIMITED
ICICI BANK LIMITED
HOUSING DEVELOPMENT FINANCE CORP. LIMITED
LARSEN & TOUBRO LIMITED
TATA CONSULTANCY SERVICES LIMITED
STATE BANK OF INDIA
OIL AND NATURAL GAS CORPORATION LTD
HINDUSTAN UNILEVER LIMITED
TATA MOTORS LIMITED
BHARTI AIRTEL LIMITED
MAHINDRA & MAHINDRA LIMITED
TATA STEEL LIMITED
NTPC LIMITED
SUN PHARMACEUTICAL INDUSTRIES LIMITED
WIPRO LIMITED
BAJAJ AUTO LIMITED
COAL INDIA LIMITED
DR. REDDY'S LABORATORIES LIMITED
HERO MOTOCORP LIMITED
BHARAT HEAVY ELECTRICALS LIMITED
JINDAL STEEL & POWER LTD
GAIL (INDIA) LIMITED
MARUTI SUZUKI INDIA LIMITED
TATA POWER CO. LIMITED
CIPLA LIMITED
HINDALCO INDUSTRIES LIMITED
STERLITE INDUSTRIES (INDIA) LTD

Annexure 3

Companies Assessed on Sep 10, 2012
NAME
ONGC VIDESH
GUJARAT URJA NIGAM
RASHTRIYA ISPAT NIGAM
NUMALIGARH REFINERY
GUJARAT STATE ELECTRICITY CORPORATION
CENTRAL COALFIELDS
ANDHRA PRADESH POWER GENERATON
GUJARAT STATE PETROLEUM COPERATION
TATA TELESERVICE
SOUTHERN POWER DISTRIBUTION
COTTON CORPORATION OF INDIA
AIRPORTS AUTHORITY OF INDIA
NUCLEAR POWER COPERATION
SECURITY PRINTING & MINTING CORPORATION
MATRIX LABRATORIES
AFCONS INFRASTRUCTURE
NATIONAL BUILDINGS CONSTRUCTION
SOMA ENTERPRISES
RAIL VIKAS NIGAM
SKOL BREWERIES
NEELACHAL ISPAT NIGAM
TATA TECHNOLOGIES
BSCPL INFRASTRUCTURE
ELECTRONICS CORPORATION OF INDIA
ENGENEERING PROJECTS (INDIA)
NORTH EASTERN ELECTRIC POWER CORP
NATIONAL PROJECTS CONSTRUCTION
RITES
HINDUSTRIAN STEEL WORKS CONSTRUCTION
INDIAN RAILWAY CATERING & TOURISM CORP

End Notes

[i] La Porta et. al., "Investor Protection and Corporate Governance", Journal of Financial Economics, 2000

[ii] "Demonstrating the Value Proposition for Good Corporate Governance", KPMG, 2011

[iii] The Monopolies and Restrictive Trade Practices Act, 1969 (replaced by the Competition Act 2002), the Foreign Exchange Regulation Act, 1973 (replaced by Foreign Exchange Management Act, 1999), the Industries (Development and Regulation) Act, 1951 and other legislations also have an influence on corporate governance frameworks. Till May 1992, the office of the Controller of Capital Issues was the nodal regulatory authority for the Indian capital markets.

Thereafter, SEBI has assumed the primary role. Additionally non-regulatory bodies have also published codes and guidelines on Corporate Governance (eg. Desirable Corporate Governance Code issued by the Confederation of Indian Industries).

[iv] Sen, Dilip Kumar., "Clause 39 of the Listing Agreement on Corporate Governance", The Chartered Accountant, December 2004

[v] The time horizons differ due to the lack of availability of annual reports for 2011-2012 in the case of unlisted companies.

[vi] OECD CGP

[vii] Section 217 (e)

[viii] Healy, Paul M., and Palepu, Krishna G., "Information Asymmetry, Corporate Disclosures and Capital Markets: A Review of the Empirical Disclosure Literature", Journal of Accounting and Economics (31), 2001

[ix] The Institute for International Finance, "Corporate Governance in India – An Investor Perspective", Task Force Report, February 2006

[x] See Chakrabarti et. al., supra note 1, at 59

[xi] OECD, "Corporate Governance and the Financial Crisis", June 2009

[xii] Previts et. al., "Corporate Governance, Auditing and the Origin of Information Rights: The Baltimore & Ohio Railroad 1827-1830", CREFIGE - Université Paris-Dauphine (not for publication)

[xiii] Schroeder, Nicholas and Gibson, Charles, "Readability of Management Discussion and Analysis", Accounting Horizons, December 1990

[xiv] The Global Reporting Initiative (GRI) is a non-profit organization that promotes economic, environmental and social sustainability. GRI provides all companies and organizations with a comprehensive sustainability reporting framework that is widely used around the world.

[xv] The universe set of companies assessed has been limited to the companies that fall under the 21 energy intensive industrial segments.

[xvi] In the case of Form A reporting, companies that are not liable to report are not included within the analysis.

[xvii] Barnett, Tim, Assistant Professor of Management, Louisiana Tech University Sam Advanced Management Journal, Autumn, 1992, pp. 37-42

[xviii] Sumant Barta 2006, Neelima Sawakar 2009

[xix] http://www.financialexpress.com/news/unlisted-cos-top-line-grows-bottom-line-erodes-in-2009/564698, 30 Nov 2012

[xx] Khanna, Vikramaditya and Mathew, Shawn J., "The Role of Independent Directors in Controlled Firms in India: Preliminary Interview Evidencer", National Law School of India Review, Vol 22(1), 2010

About GIZ

Working efficiently, effectively and in a spirit of partnership, Deutsche Gesellschaft fuer Internationale Zusammenarbeit (GIZ) GmbH supports people and societies worldwide in creating sustainable living conditions and building better futures. The services delivered by GIZ draw on a wealth of regional and technical competence and tried and tested management expertise.

It is owned by the German Government and works in the field of international cooperation for sustainable development. GIZ is also engaged in international education work around the globe. It currently operates in more than 130 countries worldwide.

About GIZ in India

Germany has been cooperating with India by providing expertise through GIZ for more than 50 years. To address India's priority of sustainable and inclusive growth, GIZ's joint efforts with the partners in India currently focus on the following areas:

- Energy - Renewable Energy and Energy Efficiency
- Sustainable Urban and Industrial Development
- Natural Resource Management
- Private Sector Development
- Social Protection
- Financial Systems Development
- HIV/AIDS-Blood Safety

About gTrade

gTrade Carbon Ex Ratings Services Private Limited (gTrade) is a company based out of India. gTrade offers focused efficiency and investment solutions to corporations and governments. These include tailored reports on firm and sector level sustainability performance. Leveraging the joint pool of resources available from the various institutional partners, the firm offers complete energy consumption metrics and emissions abatement solutions across commercial sectors of the Indian economy.

About IICA

The Indian Institute of Corporate Affairs (IICA) is an autonomous institute functioning under the aegis of the Ministry of Corporate Affairs. A think-tank, capacity building and service delivery institute, IICA's work enables corporate growth, reforms and regulation through synergised knowledge management and global partnerships.
The Institute provides a unique platform for dialogue, interaction and partnership between governments, corporate, investors, civil society, professionals, academicians and other stakeholders.

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