

Board Committees For Improving Corporate Governance: A Necessity

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INTRODUCTION

Modern day corporations are working on a market based philosophy. Globalization and liberalization of economies has opened a number of opportunities and challenges for the corporate entities. The success of any company in the present scenario depends upon the system of corporate governance prevailing in it. In fact, the system of corporate governance prevailing in corporate entities shapes the growth and future of not only a business enterprise but also of capital market and economy as such. The credibility offered by good corporate governance procedures and practices by a company helps in boosting confidence of investors- both foreign and domestic- to attract more “patient”, long- term capital, and will reduce the cost of capital (Narayana Murthy Committee Report). The Cadbury Committee (U.K.) defined corporate governance as the “system by which companies are directed and controlled”, thus placing the board of directors of a company in the center of the governance system. The blueprint suggested by various committees set up world over for ensuring good governance includes well- functioning and well informed board of directors, matching the composition of the board according to specific governance needs and taking the help of board committees such as audit committee, remuneration committee and shareholder grievance committee to meet governance objective (Gupta Pradeep and Bhayana Sanjay).

The shareholders of companies appoint board of directors to run the entity on their behalf. Thus, it becomes the duty of directors to manage the company in the best manner to enhance the wealth of shareholders who have placed high confidence in their professional skills to run the company. But the growing specialization and complexity of modern day business makes it difficult for directors to deal with each and every matter of business. The companies are realizing the need to establish separate committees of the board to deal with specific tasks as the committee system places accountability on known groups. (Today board committees are not merely legal necessity; they have become power centers in their own right).

By empowering a committee, the board can prevent the task of governance from becoming everyone’s responsibility but no one’s job (Bansal C.L.). Assigning of tasks to different sub- committees helps board of directors to improve its efficiency and performance and leads to better exchange of ideas and information. Keeping in view importance of board committees, a number of codes and guidelines issued on corporate governance world over have also necessitated setting of different committees.

OBJECTIVES

Through this paper, an attempt has been made to study the types of committees set up by Indian companies besides the ones which have been made mandatory by the clause 49 of the listing agreement and Companies Act 1956. Setting up of different sub- committees of board depends upon the nature and requirements of the company. For the purpose of the study, 70 companies were selected consisting of 35 companies each from Pharmaceutical and Information Technology sector. The annual reports of the sample companies for the period of six financial years from 2001-02 to 2006-07 have been examined to study kind of committees formed by them to improve governance practices. Below is the list of the committees which have been set up by Indian Companies in addition to mandatory audit, shareholder grievance committee, stock option committee and non- mandatory remuneration committee.

1) CORPORATE GOVERNANCE COMMITTEE:

The companies which have set up this committee have assigned it the following functions-

- To develop and recommend to the Board of Directors a set of corporate governance principles applicable to the company, to review those principles periodically and to monitor compliance of those principles.
- To review and approve new policies and practices relating to corporate governance and recommend improvements in them.
- To develop norms for evaluation of the Board of Directors.
- To recommend the areas of training needed for the Board members.

As complying with requirements relating to corporate governance has been made mandatory for listed companies under Clause 49 of the Listing Agreement, it becomes necessary that companies should set up this committee to deal with rules and regulations.

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2) RISK MANAGEMENT COMMITTEE:

Various types of risks feature significantly in the operations of many businesses. It is the responsibility of directors to set up a mechanism to ensure that the internal control of the company and risk management systems of the company are operating efficiently. The tasks assigned to this committee by sample companies are: -

- To annually review and approve the Risk Management Policy of the company.
- To ensure that the company is taking the appropriate measures to achieve prudent balance between risk and reward in both ongoing and new business activities.
- To evaluate significant risk exposures areas of the company and to assess management's actions in mitigating the exposures in a timely manner.
- To coordinate its activities with the Audit Committee in instances where there is any overlap with the audit activities.

3) CORPORATE SOCIAL RESPONSIBILITY (CSR) COMMITTEE:

Companies working in the present scenario cannot work in isolation. They depend on society for both its input and output. Companies which undertake social activities receive good response from stakeholders. So companies can set up this committee for devising its social programme. The following functions have been identified for this committee from the sample companies:

- To interpret the organizational CSR objectives and set up specific goals to be achieved towards these objectives.
- To make periodical appraisal of CSR initiatives.
- To decide about resource allocation for each of the focus areas from its corpus.
- To prepare and place before the Board the CSR Annual Report.
- To prepare and lay before the Board 'the Action Plan' for the ensuing year.
- To set up a trust and contribute to the trust such funds as may be required from the overall corpus for CSR activity.
- To select representatives/ candidates from among the members of the committee for participation in national and international seminars/ conferences, workshops, study tours and training courses.

4) ETHICS AND COMPLIANCE COMMITTEE:

The view that companies' main objective is to earn profits in the present globalised scenario is difficult to maintain. Companies must strive to achieve high level of Institutional Integrity by adopting strong ethical behaviour. According to the American Management Association, "The efficient achievement of desirable ends through acceptable means" and that ultimately is what business ethics are all about. So companies which have set up this committee have assigned it the following tasks:

- To consider matters relating to the Insider Trading Code in terms of the Company's Code of Conduct.
- To consider matters relating to the Company's Code of Conduct to be followed by directors, officers and other employees of the company.
- To take on record the status reports prepared by the Compliance Officer related to dealings in securities by the specified persons on a monthly basis.
- To decide penal action in respect of violation of the SEBI Regulations/code by any specified person.

5) EXECUTIVE COMMITTEE:

The role performed by this committee is to review and guide the company on various operational matters like:-

- Business and strategy review;
- Long-term financial projections and cash flows;
- Capital and Revenue Budgets and capital expenditure programmes; Acquisitions, divestments and business restructuring proposals;
- Senior management succession planning.

6) FINANCE COMMITTEE:

No company can survive without having adequate funds at its disposal. Managing funds in a best manner requires that this function should be dealt separately so that a timely decision relating to it is taken care of. Keeping in view the importance of finance function, some companies have set up this committee and assigned it the following tasks-

- To identify the fund-based and non-fund based requirements of the Company;
- To consider matters relating to availing financial assistance from Banks, Financial Institutions, NBFCs, Mutual Funds, Insurance Companies or any other lenders by way of term loans, working capital loans or any other funding method;
- To approve creation of the mortgages/charges in favour of lenders.

7) MANAGEMENT COMMITTEE:

The main functions performed by the committee include

- To authorize directors and officers of the company to deal with day- to day business operations such as banking, treasury, insurance, excise, customs and administrative.

- To review and approve business strategies and policies, merger and acquisition proposals, medium term plans and annual budgets.
- To review operating performance for the global organization.
- To approve processes and practices relating to human resources, succession planning for senior management personnel.
- To review policies, processes and systems on Environment, Safety and Ecology.
- To deliberate and take decisions on various corporate and legal matters to ensure smooth management of the company.

8) NOMINATION COMMITTEE:

In order to make the process of board appointment transparent and objective, companies have set up this committee with the following functions-

- To make recommendations regarding the composition of the Board;
- To identify, screen and review candidates for Executive Directors, Non- Executive Director and Independent Director positions, consistent with criteria approved by the board (including evaluation of incumbent directors for potential re-nomination), and passing on the recommendations to the board candidates.
- To take steps to refresh the composition of the Board from time to time.
- To review principles of corporate governance of the company.

Infosys Technologies has specified the role of a committee in the following manner:-

CONSULTATIVE ROLE

The Nomination Committee plays a consultative role for any appointment requiring Board approval, as stipulated by-laws or regulations, for top management positions such as CFO, Corporate Secretary, Head of HR (if the candidate for the position is not slated to be an Executive Director). It provides its advice and recommendation to the Board.

DIRECTOR EVALUATION

Coordinating and overseeing the annual self-evaluation of the performance of the Board and of individual Directors in the governance of the Company.

OTHER RESPONSIBILITIES

Reviewing and reassessing the adequacy of the Committee's charter as the need requires and recommending changes to the Board, reviewing the Company's Corporate Governance Guidelines periodically and recommending amendment to the Board as and when necessary.

SPECIFIC POWERS

- The Committee may conduct or authorize studies of matters within the Committee's scope of responsibility with full access to all books, records, facilities, and personnel of the Company.
- The Committee may, at the expense of the Company, retain advisors to assist it in connection with its functions, as it deems necessary or appropriate.
- The Company shall provide for appropriate funding, as determined by the Committee, for payment of any advisors employed by the Committee pursuant to this charter.
- The Company shall pay the ordinary administrative expenses of the Committee that are necessary or appropriate for the carrying out of its duties.

9) OPERATIONS REVIEW COMMITTEE:

The role of this committee is

- To review operations of the company other than those covered by the Audit/HR and Compensation Committee (Remuneration Committee);
- To review customer contracts, corporate financing activity, acquisitions, divestitures, internal transactions and matters relating to the subsidiaries of the Company;
- To propose detailed guidelines and policies for treasury operations.

10) STRATEGY COMMITTEE:

The role of this Committee is to:

- Participate with management to develop or modify the company's strategies, including overall mergers and acquisition plans;
- Recommend to the Board the adoption or modification of the company's strategies;
- Oversee the development of plans to implement different strategies;
- Review progress and implementation of the strategies; and
- To provide guidance on internal and external trends and developments that impact both strategy and execution.

11) CAPEX COMMITTEE:

Now-a-days, companies are operating on a large scale both in domestic and overseas markets. Mergers and acquisitions have become a common phenomenon. A large number of Indian companies are undergoing this route to expand its business. So Capex committee can help them to plan capital expenditure for the expansion and diversification programme of the company and to lay down procedures for the same.

12) COMMITTEE OF DIRECTORS FOR BANK ACCOUNTS:

As per law, a company is a separate legal entity. Large numbers of transactions are entered by directors in which payment and receipt of funds is involved. This committee is mainly responsible for approving, opening and closing of bank accounts of the company and to authorize persons to operate bank accounts of the Company.

13) INVESTMENT COMMITTEE :

In the present competitive scenario where every company is trying to achieve better results than others and grab as many opportunities as it can, this Committee can help in reviewing the Company's capital investment proposals, ongoing projects and taking timely decisions.

14) INDEPENDENT DIRECTORS RECOMMENDATION COMMITTEE:

Committees set up on corporate governance both at national and international level have time and again discussed the role of independent directors in functioning of the companies. The role of this Committee is to identify suitable persons for appointment as independent directors.

15) SENIOR MANAGEMENT PERFORMANCE REVIEW COMMITTEE:

To motivate and retain best talents in the organization, companies are setting up this committee for the purpose of determining / reviewing the remuneration, performance and related bonuses of management / compensation of Executive Directors.

16) SCIENCE COMMITTEE :

Companies which are operating in Pharma sector are mainly setting up this committee and have assigned it the following functions-

- Approval of focus areas of research, especially New Drug Discovery Research (NDDR) and Novel Drug Delivery Systems (NDDS), R&D organizational structure and policies for the research and development function of the Company;
- Monitoring progress of NDDR and NDDS programs and laying down a policy framework for collaborative R&D programs.

17) CORPORATE COMMITTEE:

This committee's main function is to advise the board on strategic planning, investment projects and annual budget plans.

18) LEGAL COMMITTEE:

This committee is responsible for monitoring the legal compliances by the Company.

ANALYSIS AND DISCUSSION

Although the list of committees presented above is quite exhaustive, it is observed from the annual reports of the companies that only a few companies have constituted any of these committees and the number of committees constituted on voluntary basis by any company is also very small. Kumar Mangalam Birla Committee rightly remarked in its report, "Under Indian conditions, a statutory rather than a voluntary code would be far more purposive and meaningful, at least, in respect of essential features of corporate governance". Table I shows the types of board committees constituted by sample companies. Analysis of the table revealed that during 2001-02, only four types of sub-committees have been formed by sample companies, but number of such sub-committees has increased steadily over the period and had gone up to 17 at the end of 2006-07. Of all the committees constituted, Nomination Committee scored maximum. While only one company (Infosys Technologies) constituted it during 2001-02, their number increased to 5 (7.14%) during 2006-07. Corporate Governance committee which was constituted by Wipro Ltd alone during 2002-03, was constituted by 3 companies during 2006-07. The number of companies forming Ethics and Compliance Committee also increased to 3 (4.3%) during 2006-07 as compared to 2002-03 when only Tata Elxsi formed it. Further, the number of companies constituting Management Committee doubled from 2 (2.9%) during 2001-02 to 4 (5.7%) during 2006-07. However, the number of companies constituting Finance Committee remained same that is, 3 over the period of study. On the other hand, while none company constituted the Executive committee and Operation Review Committee during 2001-02, their number increased to 3 (4.3%) during 2006-07.

Table –I

Type of Board Committees Constituted by the Sample Companies							
S.No	Name of Committee	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
1	Corporate Governance Committee	-	1	3	4	3	3
2	Risk Management Committee	-	-	-	-	-	1
3	Corporate Social Responsibility Committee	-	-	-	-	1	1
4	Ethics and Compliance Committee	-	1	2	3	3	3
5	Executive Committee	-	2	2	2	2	3
6	Finance Committee	3	3	4	4	4	3
7	Management Committee	2	3	3	3	4	4
8	Nomination Committee	1	1	1	1	3	5
9	Operation Review Committee	-	-	-	-	1	3
10	Strategy Committee	-	-	-	-	1	1
11	Capex Committee	-	-	-	-	2	2
12	Committee of Directors for Bank Accounts	-	-	-	1	1	1
13	Investment Committee	1	1	1	1	2	2
14	Independent Directors Recommendation Committee	-	-	1	1	1	1
15	Senior Management Performance Review Committee	-	1	1	1	1	1
16	Science Committee	-	1	1	1	1	1
17	Corporate Committee	-	-	-	1	1	-
18	Legal Committee	-	1	1	1	1	1

Source: - Annual Reports of Companies

Further, the Committees which have been constituted by single companies included Corporate Social Responsibility Committee (CSR) by Moser Baer India Ltd, Strategy Committee by Dr. Reddy Laboratories Ltd, Risk Management Committee by Infosys Technologies, Senior Management Performance Review Committee by Glaxosmithkline Pharmaceuticals Ltd, Independent Director Recommendation Committee by Lupin Ltd, Science Committee by Ranbaxy Ltd, Legal Committee by Tata Elxsi and Committee of Directors for Bank Account by Tata Consultancy Services Ltd. Company-wise analysis showed that the companies which constituted maximum number of committees that is 2 during 2001-02 were Dr. Reddy Laboratories, Ranbaxy (Management and Finance Committee), and Infosys Technologies (Investment and Nomination Committee). While both Ranbaxy (Management, Finance and Science Committee) and Tata Elxsi (Executive, Ethics and Legal Committee) constituted 3 committees each during 2002-03, 2003-04 and 2004-05, Dr. Reddy Laboratories (Management, Investment, Nomination and Strategy Committee) and Moser Baer (Corporate Governance, Finance, Corporate and Social Responsibility Committee) constituted maximum number of committees, that is, 4 during 2005-06. Tata Elxsi (Executive, Ethics and Compliance, Nomination and Legal Committee) was another company who constituted four committees along with Dr. Reddy Laboratories and Moser Baer during 2006-07.

In the revised Clause 49 of the listing agreement based on Narayana Murthy Committee Report, there is mandatory requirement that “Procedures should be in place to inform board members about the risk assessment and minimization procedures. These procedures shall be periodically reviewed to ensure that executive management controls risks through means of properly defined framework”. So companies must set up risk management committee to minimize different kinds of risks. Committees set up at both national and international level have time and again stressed on the appointment of sufficient number of non- executive independent directors on the board of directors of the companies. Cadbury committee set up in May 1991 by the Financial Reporting Council, the London stock Exchange discussed at length the importance of setting up nomination committee for making board appointments. Vineot Committee in France (1999), Derek Higgs report on the role of the effectiveness of non- executive directors (2002), Commission on Public Trust and Private Enterprise (2003) formed by the Conference board, an influential US- based non- profit making organization also recommended setting up of nomination committee of the board to conduct the process for board appointments and their training. Besides these, listing conditions of some of the leading stock exchanges of the world like London Stock Exchange, NASDAQ and New York Stock Exchange also require listed companies to form nomination committee composed of independent directors for making board appointments.

In India, Clause 49 of the Listing Agreement requires that where Chairman of the Board is a non-executive director, at least one-third of the Board should comprise of independent directors and in case he is an executive director, at least half of the Board should comprise of independent directors. Nomination committee can play an important role in finding independent directors who fulfill the independence criteria and possess required expertise to fulfill the needs of the company. Setting up of corporate governance committee helps fulfill the various corporate governance requirements not only specified by the listing agreement of Indian stock exchanges but also of stock exchanges established outside India if a company wants to get

listed abroad or needs to raise funds from foreign investors.

Keeping in view the role and functions performed by these committees, therefore, it is suggested that committees like risk management committee, nomination committee and corporate governance committee should be made mandatory for the listed companies. It can be concluded that the effort to constitute committees on a voluntary basis is minimal and only a few well-established companies constitute certain committees. Even the number of such committees is also very less. However, it may be pointed out here that certain committees are highly useful and can play a significant role in improving the corporate governance among business enterprises. Setting up of such sub-committees of directors by companies will not only help in providing expert advice but also facilitate effective decision making to meet the growing challenges and to make the best of opportunities in the years ahead.

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