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Analysis of Rising Corporate Governance Issues and Challenges for Indian Companies in Covid-19

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ABSTRACT

The purpose behind the research is to diagnose and understand the issues that are faced by the Indian Companies and how the principles of Corporate Governance can be implemented on them. Additionally, how to bring the solutions and understand the mechanisms about the Corporate Governance in India. Also, to understand the impact of Covid 19 on the Corporate Governance of the country and how the Debt Recovery Mechanism in India is disturbed due to Corona pandemic On the other hand, various initiatives taken by the Government, RBI and Ministry of Finance to combat with the devastated economy and GDP of the country. The main focus of Corporate Governance is on the rule to be followed by the Board of directors as well the internal structure of the company, the creation of the committees that will do the audit of the companies. It is a duty on the part of the corporates to protect the environment, maintain the quality of goods and services, sustainable development. Hence, the code of conduct is must to ensure such duties.

Keywords : *Corporate Governance, Directors, Responsibility, Covid 19, Pandemic*

I. INTRODUCTION

The rules, regulations, bylaws, guidelines through which the company is governed is a form of Corporate governance. In order to achieve the goals, the mission and vision of the company it is mandatory that there are some sets of procedure and guidelines to be followed by the organisations to ensure transparency and timely completion of work. A company does not consist of a single individual, it has shareholders, debenture holders, employees, customers and directors. Thus, in order to attain the accountability on the part of organisations it becomes quite mandatory that there exists a good Corporate Governance.

Since, company exists as a separate legal entity, and no one is responsible for the act of others it makes corporate governance as an important subject of study. This system of governance is

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also a process where the resources of the corporation are allocated in a manner that it maximises the value of all the stakeholders of the company including :

Equity Share Holders

Preference Share Holders

Debenture Holders

Investors

Employees

Directors

Suppliers

Customers

Environment

The model of Corporate Governance is different all around the world. As per the report of the World bank the corporate governance is a kind of political authority order to look after the problems and affairs of the society at large. In addition to this, they have explained that to promote economic development and to increase the GDP of the country a good governance is a pre condition. Undoubtedly, a country running on the principles follows rules and regulation which empowers the growth and development across the masses.

The main role of the Corporate governance is maintain a balance between the goal of the company and the individuals' goal. As well as the economic and the social phenomena existing in the country and a balance between them. Subsequently, it will ensure that the needs of the society are fulfilled. Thus, the main aim is to ensure that all the resources are used in an efficient manner and to maximise the value of the shares of the society, corporations and individuals at large.³

II. NEED FOR THE STUDY

As it is clearly seen during the last decade the failure of the corporate machinery and frauds is accusing on a rapid scale by the big corporate sectors of the country. Within the Indian legislature system we have different laws governing the corporates and their activities still there is no stop to such fraudulent acts. Thus, some of the crucial reasons for the maintaining Good Corporate Governance in India are :

³ R.A. and S.C. Myers, Principles of Corporate finance, Tata McGraw Hill, Delhi, 1997.

The company have a lot lot of share holders and debenture holders which have different perspectives towards the company's affairs. Thus, in order to protect the democracy or independency of the shareholder the corporate governance laid down its code of conduct.

Post Globalisation the FDI in the country increased on a rapid scale and the transportation between the countries also strengthens. Thus, it leads to many Indian companies registered with the International Stock Exchanges which also triggers the importance of Good Corporate Governance in the country.

Due to the Corporate feuds committed by bid enterprises such as Harshad Mehta Scam, Satyam Scam, Vijay Mallya Scam, Nirav Modi Scam the confidence of the share holders were shaken, Thus, Corporate Governance is important to bring the trust and confidence back.

The International Code of conduct is also applicable to the corporate sectors of the country due to mergers and amalgamations with the foreign companies. Thus, it requires a good code of Corporate Conduct.

III. CORPORATE GOVERNANCE PRINCIPLES WORLDWIDE

The management of the company, its shareholders, investors, and all the other stakeholders and their relationships is governed by the corporate governance. However, a Good Corporate Governance is a key that will championed the principles worldwide.⁴ The growth of economy, financial activities, sustainable development also plays a crucial role in the governance as it is directly influenced by it.

Accordingly, the concept of Corporate Social Responsibility which is made mandatory for the companies having a certain amount of turnover as fixed by the legislature is also a concept of Good Corporate Governance. Additionally, businesses should also run in such a way that it does not deplete any natural resources or the environment and should maximise it values to the fullest so that it can create a gapped social and living condition for the society at large. The values that are mandatory for the working of then company as per the principles of Good Corporate Governance includes :

Accountability

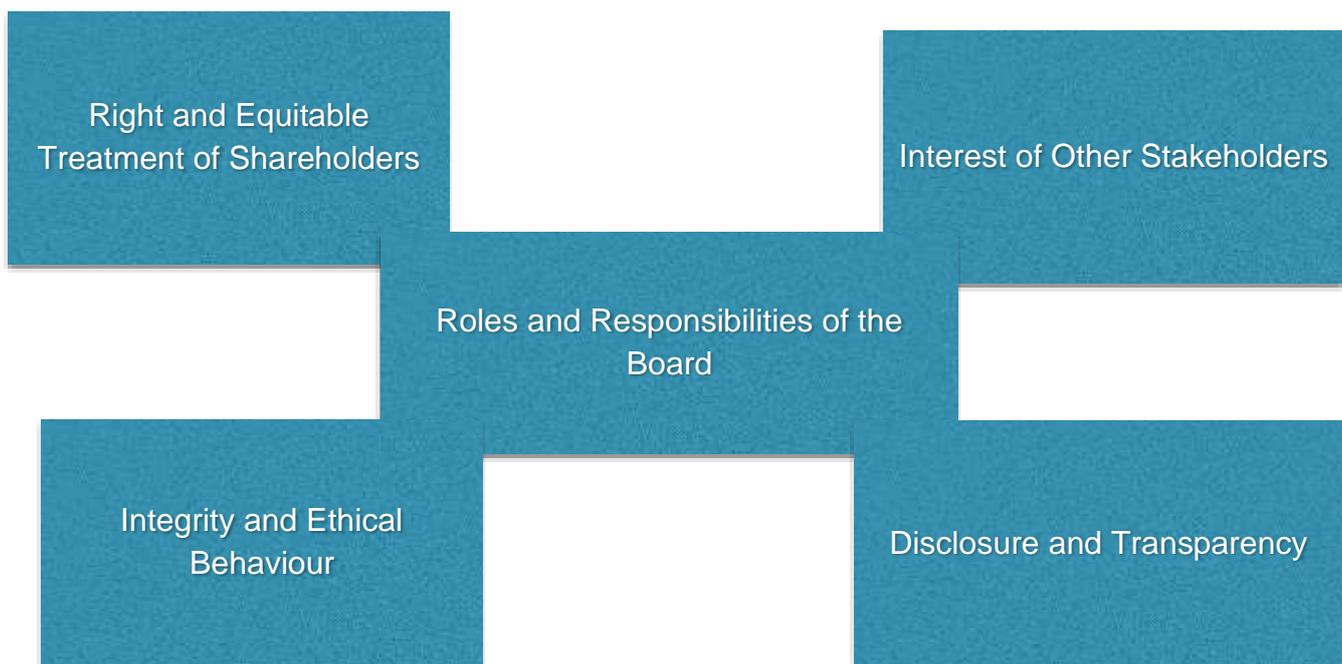
Fairness

Transparency in companies

⁴Balasubramaniam, N. (1997) "Towards Excellence in Board Performance", The IIMB Management Review, January-March, 67-84.

Corporate governance is of crucial importance for economic development in partner countries. Not only companies but regulators as well, need to drive forward improvements in CG and collaborate with others in order to provide the right incentives. Sustainable development policy and CSR are natural allies.

There are certain practices of good corporate governance which facilitates the growth and economy of the country as well as leads to the proper functioning of the corporate sector across the globe. It is explained with the help of flowchart below :



The above mention practices of the Good Corporate Governance are essential for the adequate working of the companies in order to follow a good code of conduct.⁵ When all the shareholders are treated equally there would be less chances of conflict and every information will be accessible through the general meetings. In addition to that, it will also lead to clarify the responsibilities of the directors on boards as well as their duties and obligations towards the stakeholders. Accordingly, the ethical behaviour within the organisation will also be maintained which will avoid the law suits.

Though, there are certain guidelines which are provided by OECD(Organisation for Economic Cooperation and Development) which had laid down the responsibilities of the board members. However, the practices under the Good Corporate Governance works in addition with it.

⁵ Salmon, W. J. (1993), "Crisis prevention: how to gear up your board", *Harvard Business Review*, January-February, 68-75.

IV. CHALLENGES TO EFFECTIVE CORPORATE GOVERNANCE

The independency of the directors also plays a very crucial role when it comes to the Corporate Governance. The Amin problem that is faced by the executive management of the company is to find out the directors who have the well versed knowledge in the area they are working as well as to be independent and not biased when it comes to take the crucial decision of the enterprise. However, there are certain factors which determine the independency. It includes :

Experience

Insight

Knowledge

Force of Character

Qualities of Objectivity

In many cases at the time of appointment of the director the threat that is possessed is whether they would be able to devote that much time required for the functioning and the growth of the company and their willingness towards the law suits that are filed by the shareholders.⁶ Therefore, a balance has to be maintained between the knowledge required to run the company and their independency towards the organisation.

There are certain practices which are running in a market and possess a great threat to the governance of the country. It includes:

1. Composition of Board VS Directors Competence
2. Incentives that are market driven VS Non market mechanism.
3. Fiduciary Relationship to shareholders VS Subpar disclosure and internal control.
4. Board of Directors VS Board having the committees
5. Compensation of Executives VS Regulation of RPTs
6. Relationship between the member of board management VS Controlling shareholder independence.
7. The appointment of board members and the re-election of the directors.

⁶ Meenu Assistant Professor, Dept of Public Administration, Need of Effective Corporate Governance and Its Challenges in India, International Journal of Computational Engineering & Management, Vol. 15 Issue 6, November 2012 ISSN (Online): 2230-7893

V. MAJOR ISSUES WITH CORPORATE GOVERNANCE IN INDIA

There is no doubt that what act as a boon to the society or the corporate also have several issues attached with it which makes it difficult for the working. Though there are various way in which this governance can be implemented in the country. However, certain issues with its implementation includes :

(A) THE PERFORMANCE OF THE BOARD MEMBER

There are certain provisions laid down under the Companies Act 2013 which makes it mandatory for certain members on board of the company. It includes women directors, executive and non- executive directors. Thus, a balance has to be maintained between them, otherwise it will effect the performance of the board. Sometimes it also leads to lack in transparency which leads to difficulty in the evaluation of the performance of the board members.

(B) THE INDEPENDENCY OF THE DIRECTORS

The main purpose behind the appointment of the independent directors is that it will remove the favouritism and there would be less biased in the company affairs. However, considering the current scenario its purpose is not fulfilled. Even though, there are certain guidelines that are issued by SEBI so that an unbiased audit can be done, but the situation os getting worse with every passing day.

(C) STAKEHOLDERS ACCOUNTABILITY

When an organisation works on a big scale, it have a responsibility not only towards its shareholders but also towards the society at large. The Environmental Protection Act imposes certain restrictions on the enterprises engaged in hazardous activities to ensure they not effect the environment and maintain the natural resources so that the future generation can also avail it.

(D) RISK MANAGEMENT

Usually, business involves a high level of risk and “Higher the Risk and Higher the Chances of Profit” is a maxim prevailing from a long period of time. Since, the Company laws has laid down the certain techniques of Risk Management that the directors need to complied with⁷. In addition to that, these techniques that were adopted to avoid the risk should also be mentioned in the report to be submitted to the shareholders annually.

⁷Sreeti Raut, Corporate Governance – Concepts and Issues, Research Scholar with Institute of Directors, India.

(E) DATA PROTECTION AND PRIVACY

Data Protection is the new privacy nowadays. When the world has come digital specifically during the CORONA pandemic it poses a great threat towards the personal data of the individual which available on digital platforms. Thus, in order to maintain the confidentiality of the documents available in the soft copy and their privacy the role of the organisations also come in to picture. In the era of modern governance Cyber Security is one of the most important issue.

(F) CORPORATE SOCIAL RESPONSIBILITY

Though, Corporate Social Responsibility prevailing from a long period of time, was made mandatory for the companies having a certain amount of turnover and profit after the Companies Amendment Act 2013. India is among those few countries who had made a legislative provision to implement the CSR so that the companies will not escape from it. Interestingly, during the pandemic all, the donations made towards the Prime Ministers Care Fund dedicated for Covid would also amount to CSR by the companies.⁸

VI. COVID 19 AND CORPORATE GOVERNANCE IN INDIA

The COVID 19 deadly virus had been given the status of pandemic by the WHO(World Health Organisation). Although, there were certain viruses such as Ebola, Zika which had also lead to Severe Acute Respiratory Syndrome. However, the Corona virus had reign over the all due to its high death rate globally. Undoubtedly, the impact that it had created on the businesses and the economies of the country is going to have a long lasting effect. There is no hesitation in saying that the *“Economies of the World is the patient of Corona at some point of time”*

The Government of India as well as its regulating agencies had laid down through amendments and the ordinances to facilitate a Good Corporate Governance during those hardship times. As we all know, the basic purpose behind the Corporate Governance is to maintain a healthy relationship between the company and its shareholders and imposes certain duties on the directors. During the pandemic it became more important that such principles to be adhered to its fullest so that the companies continue to grow even during the pandemic.

Additionally, a structured is also provided by the Corporate Governance which laid down the objectives of the company, how those objectives to be achieved and determines the monitoring

⁸ The Ministry of Corporate Affairs (MCA) notified the Companies (Corporate Social Responsibility Policy) Amendment Rules, 2021 which seeks to amend the Companies (Corporate Social Responsibility Policy) Rules, 2014 - 1st April 2020

of the performance.⁹

VII. MEETINGS

During the Corona pandemic the mass gathering was disallowed by the government restrictions and also the lockdown imposed does not allow to travel from one place to another. Under Section 103 of the Companies Act the limit of the Quorum to be maintained by the Company during its meetings was also disturbed. Due to the fact that in person meetings was not possible during the period of lockdown had led to an extensive amount of delay in the transactions of business and the Annual General Meetings of the companies were also adjourned.

However, there is no doubt with regard to the fact that the majority of the decisions are taken by the directors of the company still couple of decisions also requires the approval of the shareholders also. Thus, it had led to not abiding by the provisions of the Companies Act 2013.

The Annual General Meetings of the companies happens every six months and the period between the two should not exceed 15 months. Usually the financial year of the company ends on 31st of March as per their terms and conditions mentioned in the Article of Association(AOA). Due to the unforeseen times, many of the boards had decided to postpone their meetings. Moreover, due to the pandemic the statutory audit of the company came to the stake because for conducting the audit of the accounts, it is imperative to present physically at the place of the firm. However, now when the things are reinstated still the after effect can be seen.

VIII. CONTINUITY OF BUSINESS

The businesses all over the world had faced a distressed situation due to the outbreak of COVID 19. The supply chain of the enterprises came to a standstill. The firms which were engaged in providing services enabled to rendered because there was no inflow of supply components from the suppliers. Thus, it leads to facing a huge financial distress and unemployment within the country.

It is mentioned by one of the author of the global economy that ***“In the failure of the corporate companies the loss can be limited to the stakeholders of the company. However, in case of the failure of the bank the fallout can be seen and spread to many other banks as well as the entire financial institutions of the country can face the distress¹⁰”***. In addition to that the bank failure also leads to the failure of the saving investments of the investors and account holders

⁹ Defined as per G20/OECD Principles of Corporate Governance

¹⁰ Mehran, H., Morrison, A.D. and Shapiro, J.D., (2011)

of the bank. Undoubtedly the continuity of the business was one the basic issue that was faced by the enterprises.

MSME sector was the one which was hit worst due to the pandemic. The RBI in order to support the MSME entities extended the schemes.¹¹ Accordingly, existing loans to MSMEs classified as 'standard' was restructured without a downgrade in the asset classification complying with the certain conditions mentioned under the notification.

IX. IMPACT OF COVID AND DEBT RECOVERY IN INDIA

The Indian economy had faced a huge loss.¹² Many contracts that has been entered between the parties or the enterprises came to a standstill due to the inability to perform the contract. Thus, it attracted the liability of breach of contract by the party to whom harm has been caused due to such non- performance. The valuation of stock was also declined at an alarming rate. Due to all such reasons the only resort available to the creditors both the financial and operational is to take the resort of IBC. If that would have been the situation there would be unlimited number of applications in the NCLT for initiating the CIRP, which will again disturb the already distressed economy of the country. Thus, the Government of India has amended the provisions of Insolvency and Bankruptcy Code, 2016, in order to bring a pragmatic approach to design more abilities and protection.

X. AMENDMENTS BROUGHT UNDER IBC

Firstly, Section 4(1) of IBC has been amended increasing the amount of default from Rs. 1 Lakh to Rs. 1 Crore and beyond.¹³ Thus, meaning thereby the application under Section 7, 9, 10 of IBC can only be filed if the default is exceeding Rs. 1 Crore.

The Supreme Court of India, in order to provide relief to the debtors whose businesses has been adversely effected due to corona virus outbreak and nation wide lockdown had order that the period of the lockdown should be excluded for the purpose of counting the timeline.

The government of India has scrapped down Sec 7, 9, 10 of IBC for triggering the insolvency and resolution process by financial creditors, operational creditors and promoters during the distress period of lockdown.¹⁴

¹¹ Micro, Small and Medium Enterprises (MSME) sector – Restructuring of Advances. Circular DOR No. BP.BC 34/21. 04. 048/2019-20. Dated : 11th February 2020.

¹² All India Association of Industries had estimated a loss of Rs. 2,00,000 crore (\$26.35 bn) by March 31, 2020 due to pan India lockdown.

¹³ The MCA Notification No. S.O. 1205(E) dated 24.03.2020As a relief to the affected industries, on 24th March, 2020

¹⁴ Section 10A was inserted stating “Notwithstanding anything contained in Sections 7, 9 an 10, no application for initiation of corporate insolvency resolution process of a corporate debtor shall be filed, for any default arising

The Reserve bank of India has passed a gazette notification on 27th March 2020, that all banks and NBFCs have been permitted to allow a moratorium of 3 months on repayment of term loans.

Purpose, behind such amendments is to take such tools from the hands of creditors so that they cannot trigger the provisions of IBC to initiate the CIRP which if not can create hurdles in the functioning of the economy. On the other hand, if such crucial steps would not had been taken on the part of the government it would have the potentiality to disrupt the activities of MSME as well as all the other enterprises whose businesses came to a standstill due to the nation wide lockdown.

XI. NOW THAT THE CAT IS OUT OF THE BAG, WHAT COULD BE THE WAY FORWARD

The amendments brought under IBC is crucial considering the current situation as well as the declining GDP of the country. However, there is always a other way around. Undoubtedly, the creditors have other options for recovery of their debts. It includes :

1. One Time Settlement between the financial creditors and debtors in the form of a re arrangement so as to come out of the process of litigation or CIRP and to recover the money at the earliest.
2. Opting for the scheme under Section 230¹⁵ of the Companies Act. Under this, both the financial as well as the operational creditors can structure a she of restructuring with the debtor in order to make a settlement. This scheme can either be lift up by the creditors or by the liquidator.
3. Initiating the proceedings against the guarantors of the corporate debtor.
4. In case, the debtors who wants to initiate the insolvency but cannot due to the amendments under the IBC can avail for the winding up under the Companies Act, the provisions of which are still applicable.¹⁶

XII. LOOPHOLES UNDER THE CODE

Undoubtedly, the amendments that has been brought to the Insolvency and bankruptcy code will help the regain the power of the economy that was lost due to the pandemic. However,

on or after 25th March 2020, for a period of six months or such further period, not exceeding one year from such date, as may be notified in this behalf.”

¹⁵ Section 230 of the Companies Act, 2013 provides for a scheme of compromise or arrangement between the company and its creditors or class of creditors or members or class of members.

¹⁶ Winding up Rules 2020. Dated : April 1st 2020

these certain changes in the provisions had also created some loopholes the undue advantage of which can be taken.

- Firstly, is it possible that creditors as per the Purchase Order or Contract of Supply, hold raising of invoices and issue them post the completion of 6 months of the Ordinance to move the date of “default” as per their convenience to overcome the Ordinance.
- The debt recovery mechanisms provided by the Indian legislations also includes the Arbitration process or the civil proceedings in courts. In case, the creditor who cannot take the virtue of IBC, can take the recourse of other debt recovery mechanisms which are still under operation. In case, any award or decree received by the creditor in his favour, can it be used to institute proceedings under Insolvency and bankruptcy Code.
- Suits can be filed by the creditor under the Commercial Courts Act 2016. Normal Recovery Suits under the CPC as well as the summary suits under Order XXXVII. The provisions of SARFAESI can also be invoked in case of secured liabilities.
- The Ordinance has not clarified the time when the creditor can file such application of default which have occurred during the period of lockdown. Whether this portion of default can be cut through and pursued through other legal recourses.
- In order to decide the application of ordinance the date of default would be relevant to determine. In case of secured loans, when the debtors are classified as “ Non Performing Assets” will it be considered as a date of default. On the other hand, in case of Unsecured loans, in which there is default in the payment of instalments which date would be considered as the date on which the default has occurred.

There are certain judgements by the Honble’ Supreme Court of India in order to determine the default so as to trigger the provisions of the Code. In the case of Gaurav Hargovindbhai ¹⁷Dave The Supreme court held that the period of limitation will start ticking from the date on which the account of the debtor is termed as a “ NON PERFORMING ASSEST”. Now, after the ordinance if the NPA has been declared at an earlier date before the ordinance can debtor still avail the benefit of the amendment considering that the default has now arisen.

XIII. COVID 19 AND CORPORATE GOVERNANCE IN FINANCIAL INSTITUTIONS

The Central banks worldwide are quite disturbed with the impact of global pandemic on the

¹⁷ Gaurav Hargovindbhai Dave vs Asset Reconstruction Company ... on 18 September, 2019.
<https://indiankanoon.org/doc/53979742/>

economic and financial institutions of the country. The reserve bank of India had played a crucial role during these global crisis to ensure the financial stability and the free flow of the cash in the economy. In addition to this, some standards had also been laid down by the RBI with regard to :

- Appointments of Directors
- Compensation
- Roles
- Evaluation of Board of Directors

XIV. GOOD CORPORATE GOVERNANCE

In order to ensure the effective applicability of a good corporate governance all these factors were followed at the implementation level. Apart from this, several other measures were taken for the smooth functioning of the economy. It includes:

- Decrease in Repo rate¹⁸
- The moratorium period of 3 months were given to the lenders on loans.
- Decrease in the Cash Reserve Ratio
- Long Term Repo Operations were taken to provide further liquidity with the banks.
- The Reverse Repo rate was also cut down.

Apart from this the RBI is also duty bound to ensure that all the appointments of the board members should be transparent as well as laid down the duties and policies to be followed by them. Additionally, the requisite skills and knowledge required to perform the specific function should also be equipped with. There should also be diversity in the board of directors including women, youth, persons with high technical and manual skills etc to ensure the completion of work on time.

XV. CONCLUSION

The redefining of the Insolvency Law in India and certain ramifications made due to Corona outbreak had played a pivotal role in maintaining the economic stability of the country. In 2017, the position of India in Ease of Doing Business was 130th was came down to 63rd in 2020.

¹⁸ As announced in the Monetary Policy Statement, 2020-21, today, it has been decided by the Monetary Policy Committee (MPC) to reduce the policy Repo rate under the Liquidity Adjustment Facility (LAF) by 40 basis points from 4.40 per cent to **4.00 per cent** with immediate effect.

According to a World Bank statement, IBC has improved the recovery rate of stressed assets to 48% in two years, as compared to 26% in period before IBC was enacted.¹⁹

Certainly, IBC has positively impacted the industry and has led to several resolutions and liquidations and thus, has put more money in the hands of the banks and financial institutions. However, the current situation, with the rise of COVID-19 is an extraordinary one.

On the other hand, when it comes to the directors of the company who owes certain fiduciary duties towards the company, and to act in accordance with the interest of all the stakeholders. The principles of Good Corporate Governance is mandatory to followed by the countries so as to ensure the profit maximisation of the stakeholders and the due consideration is given to the needs of the society.

In the Corporate sector of India the Corporate Governance has been part from a long period of time. However, its importance raised after the fraud committed by the Satyam Computer Services Ltd. which had also break down the corporate machinery of the country.

¹⁹ Samrat Sharma, Has IBC been successful in reducing India's stressed assets./ Interview Financial Express.