Chapter 7
The Role of Business in Society: Corporate Governance, Social Responsibility, and Social Impact Management

Good corporate governance is about 'intellectual honesty' and not just sticking to rules and regulations, capital flowed towards companies that practiced this type of good governance.

– Mervyn King

Learning Objectives

Today the management, monitoring, and governance of a business are increasingly seen as separate functions to be done by separate bodies, even if some of the membership of those bodies overlaps. This is the corporate equivalent of the separation of powers. Management is the executive function, responsible for delivering the goods. Monitoring is the judicial function, responsible for seeing that the goods are delivered according to the laws of the land that standards are met and ethical principles observed. Governance is the legislative function, responsible for overseeing management and monitoring and, most important, for the corporation's future, for strategy, policy, and direction.

7.1 Case Study One: The Fall of Lehman

The case discusses the rise and fall of Lehman Brothers Inc. (Lehman Brothers) from a small dry goods store to one of the leading investment banks in the USA. It examines in detail the reasons that led to the subprime crisis since the year 2007 in the USA and how it led to the collapse of 158-year-old Lehman Brothers. The case highlights the role of several stakeholders in the mortgage business that contributed to the crisis. It examines the various factors that contributed to the fall of Lehman Brothers including leadership issues, excessive leverage failure of risk measures employed like "value at risk," and poor regulation of the investment banking industry. It also explains the role of certain OTC derivative instruments that led to the collapse of the company.

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On September 15, 2008, US-based Lehman Brothers (Lehman), one of the top five investment banks in the USA, filed for Chapter 11 bankruptcy sending shock waves through the financial sector the world over. As per the details filed by Lehman in its bankruptcy filings, it held assets worth US$ 639 billion whereas its total liabilities stood at US$ 613 billion. With this, Lehman earned the dubious distinction of having filed the biggest bankruptcy ever in the world.

The bank reported a loss of US$ 2.8 billion in the second quarter of 2008 ending May 2008, its first loss since it went public in the year 1994. However, on September 10, 2008, Lehman again reported a net loss of US$ 3.9 billion (after provisioning for US$ 5.6 billion in write-downs) for the third quarter ending August 2008 for the financial highlights of Lehman Brothers between 2003 and 2007. To turn around its operations, the bank announced a restructuring plan that intended to sell a majority stake in its investment management business (refer to Exhibit II for the business segments of Lehman Brothers). The plan also included spinning off a majority of its remaining commercial real estate holdings that had gone bad into a new public limited company. The Korea Development Bank (KDB) which had earlier evinced an interest in purchasing a 25 % equity stake in Lehman announced that it had withdrawn this offer. KDB backed off stating that the price Lehman quoted was too high, and hence it was not interested in purchasing the stake because of bad market conditions. Lehman's shares plunged by almost 45 % from US$ 14.15 to US$ 7.79 after KDB's announcement. Lehman could not manage to restore confidence in the markets and raise capital by selling a part of its equity stake and eventually had to file for Chapter 11 bankruptcy.

While many analysts attributed different reasons for the collapse of Lehman, most of them agreed that the then ongoing subprime crisis was a root cause. Analysts claimed that the move by JP Morgan Chase (JP Morgan)[7] to freeze Lehman's assets days before the bank filed for bankruptcy was one of the factors responsible for Lehman's collapse. They claimed that the bankruptcy could have been avoided if JP Morgan had not frozen Lehman's assets, which had led to a liquidity crisis.

7.2 The Subprime Crisis

In order to overcome the crisis caused by the dot com burst and 9/11 attacks, the US government adopted a policy of credit-driven consumption led growth for its economy. To stimulate consumption, American policy makers started slashing interest rates to ease the liquidity in the system from late 2001.

Industry experts blamed the subprime crisis and the resultant collapse of Lehman Brothers on the global macroeconomic imbalance that the USA had created. The US economy had a savings rate close to zero in 2007. Experts opined that with the huge fiscal deficit and balance of payment deficit the USA had, the US dollar (dollar) would have depreciated unless it was a global currency. The Fed's decision to let Lehman file for bankruptcy rather than providing a bailout solution attracted mixed reactions from several analysts. Many analysts criticized US Treasury

Secretary Henry M. Paulson's (Paulson) decision for not bailing out Lehman, whereas another Wall Street investment bank Bear Stearns had been bailed out in March 2008.

7.3 Introduction

Business is expected to create wealth and employment, while society is expected to provide a conducive environment for the business to flourish. The value and ethical standards that a company adopts are the long-term assets of the organization.

There are a number of tasks that a business has to fulfill to the society. These include the financial task, political task, environment task, adaptive task, economic task, and social tasks. Financial tasks include laying down policies and guidelines for the proper functioning of the financial systems. The environmental tasks include the responsibility of an organization towards the environment. With the perceptions of the consumers changing towards products that are harmful to the environment, companies have to show their concern for the environment by producing environmentally friendly products. The maintenance tasks include the involvement of organizations with nonprofit organizations in providing service to the society.

Social task includes providing equal opportunity for all the members of the society by organizations and taking into consideration the basic human rights of an employee. The way an organization responds to its responsibility to the society has been discussed with special reference to the enlightenment matrix. The organizations responsibility towards employees are improving working conditions, maintaining open and honest communications, welcoming suggestions/complaints, providing equal opportunity, etc. Management plays a key role in balancing the multiple claims of stakeholders. Therefore the responsibility of management involves maintaining healthy relationships among the stakeholders. The organizations responsibilities towards consumers include offering quality goods, providing prompt services, and treating customers fairly. Good relations with suppliers will determine the profitability of the company. The company must treat its suppliers with respect. Suppliers/creditors must be paid promptly. Companies must also follow ethical competitive practices. Finally, the responsibilities of the organization are respecting human rights, improving workplace safety and economic well-being, etc.

The Enron scandal in 2001 eventually led to the bankruptcy of the Enron Corporation, and the dissolution of Arthur Andersen, one of the five largest audit and accountancy firms in the world. In addition to being the largest bankruptcy reorganization in American history at that time, Enron undoubtedly was the biggest audit failure. As a consequence of the Enron scandal in 2001, new regulations and legislation were enacted to expand the reliability of financial reporting for public companies. The *Sarbanes-Oxley Act* was introduced in 2002 to increase the accountability of auditing firms to remain objective and independent of their clients.

7.4 Sarbanes-Oxley Act

The Sarbanes-Oxley Act of 2002 (often shortened to SOX and named for its sponsors Senator Paul Sarbanes and Representative Michael G. Oxley) is a law that was passed in response to the financial scandals such as Enron and WorldCom. The law establishes new, stricter standards for all US publicly traded companies. It does not apply to private companies. The Act is administered by the Securities and Exchange Commission (SEC), which deals with compliance, rules, and requirements. The Act also created a new agency, the Public Company Accounting Oversight Board, or PCAOB, which is in charge of overseeing, regulating, inspecting, and disciplining accounting firms in their roles as auditors of public companies.

7.5 The Intent of the Sarbanes-Oxley Act

To protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws and for other purposes.

Key Sections

1. Section 201 outlines prohibited auditor activities.
2. Section 302 describes the CEO's and CFO's new responsibilities regarding corporate reports.
3. Section 404 addresses the management assessment of internal controls.
4. Section 409 outlines real time disclosure.
5. Section 802 describes criminal penalties for altering documents.
6. Section 806 describes whistleblower protection.
7. Section 807 describes criminal penalties for fraud.

The Sarbanes-Oxley Act created new standards for corporate accountability as well as new penalties for acts of wrongdoing. It changes how corporate boards and executives must interact with each other and with corporate auditors. It removes the defense of "I wasn't aware of financial issues" from CEOs and CFOs, holding them accountable for the accuracy of financial statements. The Act specifies new financial reporting responsibilities, including adherence to new internal controls and procedures designed to ensure the validity of their financial records.

The Act requires all financial reports to include an internal control report. This is designed to show that not only are the company's financial data accurate, but the company has confidence in them because adequate controls are in place to safeguard financial data. Year-end financial reports must contain an assessment of the effectiveness of the internal controls. The issuer's auditing firm is required to attest to that assessment. The auditing firm does this after reviewing controls, policies, and procedures during a Section 4040 audit, conducted along with a traditional financial audit.

The US Sarbanes-Oxley Act was passed in the wake of a myriad of corporate scandals. What these scandals had in common was skewed reporting of selected financial transactions. For instance, companies such as Enron, WorldCom, and Tyco covered up or misrepresented a variety of questionable transactions, resulting in huge losses to stakeholders and a crisis in investor confidence. How did Congress think the Act would address the problem? Sarbanes-Oxley aims to enhance corporate governance and strengthen corporate accountability. It does that by:

1. Formalizing and strengthening internal checks and balances within corporations.
2. Instituting various new levels of control and sign-off designed to ensure that financial reporting exercises full disclosure.
3. Corporate governance is transacted with full transparency.

SOX applies to all public companies in the USA 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.

Source: http://www.sox-online.com/basics.html

7.6 Cadbury Committee Report (1992)

The "Cadbury Committee" was set up in May 1991 with a view to overcome the huge problems of scams and failures occurring in the corporate sector worldwide in the late 1980s and the early 1990s. It was formed by the Financial Reporting Council, the London Stock of Exchange, and the accountancy profession, with the main aim of addressing the financial aspects of corporate governance. Other objectives include (1) uplift the low level of confidence both in financial reporting and in the ability of auditors to provide the safeguards which the users of company's reports sought and expected; (2) review the structure, rights, and roles of board of directors, shareholders, and auditors by making them more effective and accountable; (3) address various aspects of accountancy profession and make appropriate recommendations, wherever necessary; and (4) raise the standard of corporate governance. Keeping this in view, the Committee published its final report on December 1, 1992. The report was mainly divided into three parts:

Reviewing the structure and responsibilities of boards of directors and recommending a Code of Best Practice, the boards of all listed companies should comply with the Code of Best Practice. All listed companies should make a statement about their compliance with the Code in their report and accounts as well as give reasons for any areas of noncompliance. The Code of Best Practice is segregated into four sections and their respective recommendations are:

Board of Directors: The board should meet regularly, retain full and effective control over the company, and monitor the executive management. There should be a clearly accepted division of responsibilities at the head of a company, which will ensure a balance of power and authority, such that no one individual has unfettered powers of decision. Where the chairman is also the chief executive, it is essential that there should be a strong and independent element on the board, with a recognized senior member. Besides, all directors should have access to the advice and services of the company secretary, who is responsible to the board for ensuring that board procedures are followed and that applicable rules and regulations are complied with.

Nonexecutive Directors: The nonexecutive directors should bring an independent judgment to bear on issues of strategy, performance, resources, including key appointments, and standards of conduct. The majority of nonexecutive directors should be independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgment, apart from their fees and shareholding.

Executive Directors: There should be full and clear disclosure of directors' total emoluments and those of the chairman and highest-paid directors, including pension contributions and stock options, in the company's annual report, including separate figures for salary and performance-related pay.

Financial Reporting and Controls: It is the duty of the board to present a balanced and understandable assessment of their company's position, in reporting of financial statements, for providing true and fair picture of financial reporting. The directors should report that the business is a going concern, with supporting assumptions or qualifications as necessary. The board should ensure that an objective and professional relationship is maintained with the auditors.

7.6.1 Considering the Role of Auditors and Addressing a Number of Recommendations to the Accountancy Profession

The annual audit is one of the cornerstones of corporate governance. It provides an external and objective check on the way in which the financial statements have been prepared and presented by the directors of the company. The Cadbury Committee recommended that a professional and objective relationship between the board of directors and auditors should be maintained, so as to provide to all a true and fair view of company's financial statements.

Auditors' role is to design audit in such a manner so that it provides a reasonable assurance that the financial statements are free of material misstatements. Further, there is a need to develop more effective accounting standards, which provide important reference points against which auditors exercise their professional judgment. Secondly, every listed company should form an audit committee which gives the auditors direct access to the nonexecutive members of the board. The Committee further recommended for a regular rotation of audit partners to prevent unhealthy relationship between auditors and the management.

It is also recommended for disclosure of payments to the auditors for non-audit services to the company. The accountancy profession, in conjunction with representatives of preparers of accounts, should take the lead in (1) developing a set of criteria for assessing effectiveness, (2) developing guidance for companies on the form in which directors should report, and (3) developing guidance for auditors on relevant audit procedures and the form in which auditors should report. However, it should continue to improve its standards and procedures.

7.6.2 Dealing with the Rights and Responsibilities of Shareholders

The shareholders, as owners of the company, elect the directors to run the business on their behalf and hold them accountable for its progress. They appoint the auditors to provide an external check on the directors' financial statements. The Committee's report places particular emphasis on the need for fair and accurate reporting of a company's progress to its shareholders, which is the responsibility of the board. It is encouraged that the institutional investors/shareholders to make greater use of their voting rights and take positive interest in the board functioning. Both shareholders and boards of directors should consider how the effectiveness of general meetings could be increased as well as how to strengthen the accountability of boards of directors to shareholders.

Source: http://business.gov.in/corporate_governance/cadbury_report.php

7.7 OECD Guidelines

One of the most influential guidelines has been the 1999 OECD Principles of Corporate Governance. This was revised in 2004. The OECD guidelines are often referenced by countries developing local codes or guidelines. Building on the work of the OECD, other international organizations, private sector associations, and more than 20 national corporate governance codes, the United Nations Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) has produced their Guidance on Good Practices in Corporate Governance Disclosure. This internationally agreed [25] benchmark consists of more than 50 distinct disclosure items across five broad categories:

1. Auditing
2. Board and management structure and process
3. Corporate responsibility and compliance
4. Financial transparency and information disclosure
5. Ownership structure and exercise of control rights

The investor-led organization International Corporate Governance Network (ICGN) was set up by individuals centered around the ten largest pension funds in the world 1995. The aim is to promote global corporate governance standards. The network is led by investors that manage 18 trillion dollars and members are located in 50 different countries. ICGN has developed a suite of global guidelines ranging from shareholder rights to business ethics. The World Business Council for Sustainable Development (WBCSD) has done work on corporate governance, particularly on accountability and reporting, and in 2004 released Issue Management Tool: Strategic challenges for business in the use of corporate responsibility codes, standards, and frameworks. This document offers general information and a perspective from a business association/think tank on a few key codes, standards, and frameworks relevant to the sustainability agenda.

In 2009, the International Finance Corporation and the UN Global Compact released a report, Corporate Governance: the Foundation for Corporate Citizenship and Sustainable Business, linking the environmental, social, and governance responsibilities of a company to its financial performance and long-term sustainability.

Most codes are largely voluntary. An issue raised in the USA since the 2005 Disney decision is the degree to which companies manage their governance responsibilities, in other words, do they merely try to supersede the legal threshold or should they create governance guidelines that ascend to the level of best practice. For example, the guidelines issued by associations of directors, corporate managers, and individual companies tend to be wholly voluntary, but such documents may have a wider effect by prompting other companies to adopt similar practices.

7.8 Corporate Governance in India

The Securities and Exchange Board of India (SEBI) had constituted a Committee on Corporate Governance and circulated the recommendations to all stock exchanges for implementation by listed entities as part of the listing agreement vide SEBI's circular SMDRP/Policy/CIR-10/2000 dated February 21, 2000. Full text of recommendations of the Committee which form part of the above circular can be had by access to SEBI's website, www.sebi.gov.in/circulars/2000. A summary of the important recommendations of the SEBI Committee as applicable to banks is furnished here under:

1.1. All pecuniary relationship or transactions of the nonexecutive directors should be disclosed in the annual report.
1.2. The Committee is of the view that nonexecutive directors help bring an independent judgment to bear on board's deliberations, especially on issues of strategy, performance, management of conflicts, and standards of conduct. The Committee therefore lays emphasis on the caliber of the nonexecutive directors, especially of the independent directors.
1.3. The Committee is of the view that it is important that an adequate compensation package be given to the nonexecutive independent directors so that these positions become sufficiently financially attractive to attract talent and that the nonexecutive directors are sufficiently compensated for undertaking this work.

1.4. The Committee recommends that the board of a company have an optimum combination of executive and nonexecutive directors with not less than 50 % of the board comprising the nonexecutive directors. The number of independent directors depends on the nature of the chairman of the board. In case a company has a nonexecutive chairman, at least half of board should be independent (mandatory recommendation).
2.1. The Committee recommends that when a nominee of the institutions is appointed as a director of the company, he should have the same responsibility, be subject to the same discipline, and be accountable to the shareholders in the same manner as any other director of the company. In particular, if he reports to any department of the institutions on the affairs of the company, the institution should ensure that there exist Chinese walls between such department and other department which may be dealing in the shares of the company in the stock market.
3.1. The Committee recommends that a nonexecutive chairman should be entitled to maintain a chairman's office at the company's expense and also allowed reimbursement of expenses incurred in performance of his duties. This will enable him to discharge the responsibilities effectively.
1.1. The Committee recommends that a qualified and independent audit committee should be set up by the board of a company (mandatory recommendation).
1.2. The Committee recommends that:

- The audit committee should have a minimum of three members, all being nonexecutive directors, with the majority being independent and with at least one director having financial and accounting knowledge.
- The chairman of the committee should be an independent director.
- The chairman should be present at the Annual General Meeting to answer shareholder queries.
- The audit committee should invite such of the executives as it considers appropriate (and particularly the head of the finance function) to be present at the meetings of the Committee but on occasions, it may also meet without the presence of any executives of the company. The finance director and head of internal audit, and, when required, a representative of the external auditor should be present as invitees for the meetings of the audit committee.
- The company secretary should act as the secretary to the committee.

4.3. The Committee recommends that the audit committee should meet at least thrice a year. One meeting must be held before finalization of annual accounts and one necessarily every 6 months (mandatory recommendation).
4.4. The quorum should be either two members or one-third of the members of the audit committee, whichever is higher, and there should be a minimum of two independent directors (mandatory recommendation).
4.5. Being a committee of the board, the audit committee derives its powers from the authorization of the board. The Committee recommends that such powers should include powers:

1. To investigate any activity within its terms of reference
2. To seek information from any employee

3. To obtain outside legal or other professional advice
4. To secure attendance of outsiders with relevant expertise, if it considers necessary

   - Discussion with external auditors, before the audit commences, of the nature, and scope of audit. Also postaudit discussion to ascertain any area of concern
   - Reviewing the company's financial and risk management policies
   - Looking into the reasons for substantial defaults in the payments to the depositors, debenture holders, shareholders (in case of nonpayment of declare dividends), and creditors

This is a mandatory recommendation.

5.1. The Committee recommends that the board should 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.
6.1. The Committee therefore recommends that board meetings should be held at least four times in a year, with a maximum time gap of 4 months between any two meetings. The minimum information should be available to the board (mandatory recommendation).
6.2. The committee recommends that a director should not be a member in more than ten committees or act as chairman of more than five committees across all companies in which he is a director. Furthermore, it is a mandatory annual requirement for every director to inform the company about the committee positions he occupies in other companies and notify changes as and when they take place (mandatory recommendation).
7.1. The recommendations contained in this section pertain to accounting standards on consolidation, segment reporting, disclosure, and treatment of related party transactions and deferred taxation. The Committee recommended that the Institute of Chartered Accountants of India issue accounting standards on these areas expeditiously.
8.1. As a part of the disclosure related to Management, the Committee recommends that 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 (mandatory recommendation).
8.2. The committee recommends that disclosures be made by 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 (e.g., dealing in company shares, commercial dealings with bodies which have shareholding of management and their relatives) (mandatory recommendation).
9.1. The Committee recommends that in case of the appointment of a new director or reappointment of a director, the shareholders must be provided with the following information:

4.6. As the audit committee acts as the bridge between the board, the statutory auditors, and internal auditors, the Committee recommends that its role should include the following:

- Oversight of the company's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient, and credible
- Recommending the appointment and removal of the external auditor, fixation of audit fee, and also approval for payment for any other service
- Reviewing with management the annual financial statements before submission to the board, focusing primarily on:
  - Any changes in accounting policies and practices
  - Major accounting entries based on exercise of judgment by management
  - Qualifications in draft audit report
  - Significant adjustment arising out of audit
  - The going concern assumption
  - Compliance with accounting standards
  - Compliance with stock exchange and legal requirement concerning financial institutions
  - Any related party transactions, i.e., transactions of the company of material nature, with promoters or the management, their subsidiaries or relatives that may have potential conflict with the interests of company at large
- Reviewing with the management, external and internal auditors, and the adequacy of internal control systems
- Reviewing the adequacy of the internal audit function, including the structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure, coverage, and frequency of internal audit
- Discussion with the internal auditors of any significant findings and follow-up thereon
- Reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the board
- A brief resume of the director
- Nature of his expertise in specific financial areas
- Names of the companies in which the person also holds the directorship and the membership of committees of the board

This is a mandatory recommendation.

9.2. The Committee recommends that information like quarterly results and presentation made by companies to analysts may be put on company's website; 6r may be sent in such a form so as to enable the stock exchange on which the company is listed to put it on its own website (mandatory recommendation).

9.3. The Committee recommends that the half-yearly declaration of financial performance including summary of the significant events in last 6 months should be sent to each household of shareholders.

9.4. The Committee recommends that a board committee under the chairmanship of a nonexecutive director should be formed to specifically look into the redressing of shareholder complaints like transfer of shares, nonreceipt of balance sheet, and nonreceipt of declared dividends. The Committee believes that the formation of such a committee will help focus the attention of the company on shareholders' grievances and sensitize the management to redressal of their grievances (mandatory recommendation).

9.5. The Committee further recommends that to expedite the process of share transfers, the board of the company should delegate the power of share transfer to an officer or a committee or to the registrar and share transfer agents. The delegated authority should attend to share transfer formalities at least once in a fortnight (mandatory recommendation).

10. The Committee recommends that there should be a separate section on corporate governance in the annual reports of companies, with a detailed compliance report on corporate governance. Noncompliance of any mandatory recommendation with reasons thereof and the extent to which the nonmandatory recommendations have been adopted should be specifically highlighted. This will enable the shareholders and the securities market to assess for themselves the standards of corporate governance followed by a company (mandatory recommendation).

The organizational framework for corporate governance initiatives in India consists of the Ministry of Corporate Affairs (MCA) and the Securities and Exchange Board of India (SEBI). The first formal regulatory framework for listed companies specifically for corporate governance was established by the SEBI in February 2000, following the recommendations of Kumar Mangalam Birla Committee Report. It was enshrined as Clause 49 of the listing agreement.

Thereafter SEBI had set up another committee under the chairmanship of Mr. N. R. Narayana Murthy, to review Clause 49, and suggest measures to improve corporate governance standards. Some of the major recommendations of the committee primarily related to audit committees, audit reports, independent directors, related party transactions, risk management, directorships and director compensation, codes of conduct, and financial disclosures.

The Ministry of Corporate Affairs had also appointed a Naresh Chandra Committee on Corporate Audit and Governance in 2002 in order to examine various corporate governance issues. It made recommendations in two key aspects of corporate governance: financial and nonfinancial disclosures and independent auditing and board oversight of management.

It had also set up a National Foundation for Corporate Governance (NFCG) in association with the CII, ICAI, and ICSI as a not-for-profit trust to provide a platform to deliberate on issues relating to good corporate governance, to sensitize corporate leaders on the importance of good corporate governance practices, as well as to facilitate exchange of experiences and ideas among corporate leaders, policy makers, regulators, law enforcing agencies, and nongovernment organizations.

Good governance in capital market has always been high on the agenda of SEBI. Corporate governance is looked upon as a distinctive brand and benchmark in the profile of corporate excellence. This is evident from the continuous update of guidelines, rules, and regulations by SEBI for ensuring transparency and accountability. In the process, SEBI had constituted a Committee on Corporate Governance under the chairmanship of Shri Kumar Mangalam Birla. The Committee in its report observed that "the strong Corporate Governance is indispensable to resilient and vibrant capital markets and is an important instrument of investor protection. It is the blood that fills the veins of transparent corporate disclosure and high quality accounting practices. It is the muscle that moves a viable and accessible financial reporting structure."

Based on the recommendations of the Committee, the SEBI had specified principles of corporate governance and introduced a new Clause 49 in the listing agreement of the stock exchanges in the year 2000. These principles of corporate governance were made applicable in a phased manner, and all the listed companies with the paid up 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 were covered as of March 31, 2003.

SEBI, as part of its endeavor to improve the standards of corporate governance in line with the needs of a dynamic market, constituted another Committee on Corporate Governance under the chairmanship of Shri N. R. Narayana Murthy to review the performance of corporate governance and to determine the role of companies in responding to rumor and other price sensitive information circulating in the market in order to enhance the transparency and integrity of the market. The Committee in its Report observed that "the effectiveness of a system of Corporate Governance cannot be legislated by law, nor can any system of Corporate Governance be static. In a dynamic environment, system of Corporate Governance needs to be continually evolved."

With a view to promote and raise the standards of corporate governance, SEBI on the basis of recommendations of the Committee and public comments received on the report and in exercise of powers conferred by Section 11(1) of the Securities and Exchange Board of India Act, 1992, read with Section 10 of the Securities Contracts (Regulation) Act 1956 and revised the existing Clause 49 of the listing agreement vide its circular SEBI/MRD/SE/31/2003/26/08 dated August 26, 2003. It clarified that some of the subclauses of the revised Clause 49 shall be suitably modified or new clauses shall be added following the amendments to the Companies Act 1956 by the Companies (Amendment) Bill/Act 2003, so that the relevant provisions of the clauses on corporate governance in the listing agreement and the Companies Act remain harmonious with one another.

The Securities and Exchange Board of India (SEBI) has formulated guidelines for corporate governance by listed companies through the listing agreement. The relevant clause is Clause 49 – corporate governance. These have and would continually evolve. Given below are the guidelines as enunciated by SEBI in October 2004. These are for information only and no responsibility is accepted.

7.9 Clause 49: New Initiatives in Corporate Governance

The company agrees to comply with the following provisions:

7.9.1 Board of Directors

7.9.1.1 Composition of Board

(i) The board of directors of the company shall have an optimum combination of executive and nonexecutive directors with not less than 50 % of the board of directors comprising of nonexecutive directors.

(ii) Where the chairman of the board is a nonexecutive 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.

(iii) For the purpose of the subclause (ii), the expression "independent director" shall mean a nonexecutive director of the company who:

  (a) Apart from receiving director's remuneration, does not have any material pecuniary relationships or transactions with the company, its promoters, its directors, its senior management or its holding company, its subsidiaries, and associates which may affect independence of the director
  (b) Is not related to promoters or persons occupying management positions at the board level or at one level below the board
  (c) Has not been an executive of the company in the immediately preceding three financial years
  (d) Is not a partner or an executive or was not partner or an executive during the preceding 3 years, of any of the following:

(i) The statutory audit firm or the internal audit firm that is associated with the company

(ii) The legal firm(s) and consulting firm(s) that have a material association with the company

  (e) Is not a material supplier, service provider, or customer or a lessor or lessee of the company, which may affect independence of the director
  (f) Is not a substantial shareholder of the company, i.e., owning 2 % or more of the block of voting shares

Explanation
For the purposes of the subclause (iii):

  (a) Associate shall mean a company which is an "associate" as defined in Accounting Standard (AS) 23, "Accounting for Investments in Associates in Consolidated Financial Statements," issued by the Institute of Chartered Accountants of India.

(b) "Senior management" shall mean personnel of the company who are members of its core management team excluding board of directors. Normally, this would comprise all members of management one level below the executive directors, including all functional heads.
(c) "Relative" shall mean "relative" as defined in Section 2(41) and Section 6 read with Schedule IA of the Companies Act, 1956.

(iv) Nominee directors appointed by an institution which has invested in or lent to the company shall be deemed to be independent directors.

Explanation
"Institution" for this purpose means a public financial institution as defined in Section 4A of the Companies Act, 1956, or a "corresponding new bank" as defined in Section 2(d) of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970, or the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 [both Acts]."

7.9.1.2 Nonexecutive Directors' Compensation and Disclosures

All fees/compensation, if any paid to nonexecutive directors, including independent directors, shall be fixed by the board of directors and shall require previous approval of shareholders in general meeting. The shareholders' resolution shall specify the limits for the maximum number of stock options that can be granted to nonexecutive directors, including independent directors, in any financial year and in aggregate.

7.9.1.3 Other Provisions as to Board and Committees

(i) The board shall meet at least four times a year, with a maximum time gap of 3 months between any two meetings. The minimum information to be made available to the board is given in *Annexure: I A*.
(ii) A director shall not be a member in more than ten committees or act as chairman of more than five committees across all companies in which he is a director. Furthermore it should be a mandatory annual requirement for every director to inform the company about the committee positions he occupies in other companies and notify changes as and when they take place.

Explanation

1. For the purpose of considering the limit of the committees on which a director can serve, all public limited companies, whether listed or not, shall be included and all other companies including private limited companies, foreign companies, and companies under Section 25 of the Companies Act shall be excluded.
2. For the purpose of reckoning the limit under this subclause, chairmanship/membership of the audit committee and the Shareholders' Grievance Committee alone shall be considered.

(iii) The board shall periodically review compliance reports of all laws applicable to the company, prepared by the company as well as steps taken by the company to rectify instances of noncompliances.

7.9.1.4 Code of Conduct

(i) The board shall lay down a code of conduct for all board members and senior management of the company. The code of conduct shall be posted on the website of the company.
(ii) All board members and senior management personnel shall affirm compliance with the code on an annual basis. The annual report of the company shall contain a declaration to this effect signed by the CEO.

Explanation: For this purpose, the term "senior management" shall mean personnel of the company who are members of its core management team excluding board of directors. Normally, this would comprise all members of management one level below the executive directors, including all functional heads.

7.9.2 Audit Committee

7.9.2.1 Qualified and Independent Audit Committee

A qualified and independent audit committee shall be set up, giving the terms of reference subject to the following:

(i) The audit committee shall have a minimum three directors as members. Two-thirds of the members of audit committee shall be independent directors.
(ii) All members of audit committee shall be financially literate, and at least one member shall have accounting or related financial management expertise.

Explanation 1: The term "financially literate" means the ability to read and understand basic financial statements, i.e., balance sheet, profit and loss account, and statement of cash flows.

Explanation 2: A member will be considered to have accounting or related financial management expertise if he or she possesses experience in finance or accounting or requisite professional certification in accounting or any other comparable experience or background which results in the individual's financial sophistication, including being or having been a chief executive officer, chief financial officer, or other senior officer with financial oversight responsibilities.

(iii) The chairman of the audit committee shall be an independent director.
(iv) The chairman of the audit committee shall be present at Annual General Meeting to answer shareholder queries.

(v) The audit committee may invite such of the executives, as it considers appropriate (and particularly the head of the finance function) to be present at the meetings of the committee, but on occasions it may also meet without the presence of any executives of the company. The finance director, head of internal audit, and a representative of the statutory auditor may be present as invitees for the meetings of the audit committee.
(vi) The Company Secretary shall act as the secretary to the committee.

7.9.2.2 Meeting of Audit Committee

The audit committee should meet at least four times in a year and not more than 4 months shall elapse between two meetings. The quorum shall be either two members or one-third of the members of the audit committee whichever is greater, but there should be a minimum of two independent members present.

7.9.2.3 Powers of Audit Committee

The audit committee shall have powers, which should include the following:

1. To investigate any activity within its terms of reference
2. To seek information from any employee
3. To obtain outside legal or other professional advice
4. To secure attendance of outsiders with relevant expertise, if it considers necessary

7.9.2.4 Role of Audit Committee

The role of the audit committee shall include the following:

1. Oversight of the company's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient, and credible.
2. Recommending to the board, the appointment, reappointment, and, if required, the replacement or removal of the statutory auditor and the fixation of audit fees
3. Approval of payment to statutory auditors for any other services rendered by the statutory auditors
4. Reviewing, with the management, the annual financial statements before submission to the board for approval, with particular reference to:

   (a) Matters required to be included in the Director's Responsibility Statement to be included in the board's report in terms of Clause (2AA) of Section 217 of the Companies Act, 1956
   (b) Changes, if any, in accounting policies and practices and reasons for the same
   (c) Major accounting entries involving estimates based on the exercise of judgment by management

(d) Significant adjustments made in the financial statements arising out of audit findings
(e) Compliance with listing and other legal requirements relating to financial statements
(f) Disclosure of any related party transactions
(g) Qualifications in the draft audit report

5. Reviewing, with the management, the quarterly financial statements before submission to the board for approval
6. Reviewing, with the management, performance of statutory and internal auditors and adequacy of the internal control systems
7. Reviewing the adequacy of internal audit function, if any, including the structure of the internal audit department, staffing, and seniority of the official heading the department, reporting structure coverage and frequency of internal audit
8. Discussion with internal auditors any significant findings and follow-up there on, page 7 of 18
9. Reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the board
10. Discussion with statutory auditors before the audit commences, about the nature and scope of audit as well as postaudit discussion to ascertain any area of concern
11. To look into the reasons for substantial defaults in the payment to the depositors, debenture holders, shareholders (in case of nonpayment of declared dividends), and creditors
12. To review the functioning of the whistle-blower mechanism, in case the same is existing
13. Carrying out any other function as is mentioned in the terms of reference of the audit committee

Explanation (i): The term "related party transactions" shall have the same meaning as contained in the Accounting Standard 18, Related Party Transactions, issued by The Institute of Chartered Accountants of India.

Explanation (ii): If the company has set up an audit committee pursuant to provision of the Companies Act, the said audit committee shall have such additional functions/features as is contained in this clause.

7.9.2.5 Review of Information by Audit Committee

The audit committee shall mandatorily review the following information:

1. Management Discussion and Analysis of financial condition and results of operations
2. Statement of significant related party transactions (as defined by the audit committee), submitted by management
3. Management letters/letters of internal control weaknesses issued by the statutory auditors

4. Internal audit reports relating to internal control weaknesses
5. The appointment, removal, and terms of remuneration of the chief internal auditor shall be subject to review by the audit committee

7.9.3 Subsidiary Companies

(i) At least one independent director on the board of directors of the holding company shall be a director on the board of directors of a material non-listed Indian subsidiary company.
(ii) The audit committee of the listed holding company shall also review the financial statements, in particular, the investments made by the unlisted subsidiary company.
(iii) The minutes of the board meetings of the unlisted subsidiary company shall be placed at the board meeting of the listed holding company. The management should periodically bring to the attention of the board of directors of the listed holding company, a statement of all significant transactions and arrangements entered into by the unlisted subsidiary company.

Explanation 1: The term “material non-listed Indian subsidiary” shall mean an unlisted subsidiary, incorporated in India, whose turnover or net worth (i.e., paid up capital and free reserves) exceeds 20 % of the consolidated turnover or net worth, respectively, of the listed holding company and its subsidiaries in the immediately preceding accounting year.

Explanation 2: The term “significant transaction or arrangement” shall mean any individual transaction or arrangement that exceeds or is likely to exceed 10 % of the total revenues or total expenses or total assets or total liabilities, as the case may be, of the material unlisted subsidiary for the immediately preceding accounting year.

Explanation 3: Where a listed holding company has a listed subsidiary which is itself a holding company, the above provisions shall apply to the listed subsidiary insofar as its subsidiaries are concerned.

7.9.4 Disclosures

7.9.4.1 Basis of Related Party Transactions

(i) A statement in summary form of transactions with related parties in the ordinary course of business shall be placed periodically before the audit committee.
(ii) Details of material individual transactions with related parties which are not in the normal course of business shall be placed before the audit committee.

(iii) Details of material individual transactions with related parties or others, which are not on an arm's length basis should be placed before the audit committee, together with Management's justification for the same.

7.9.4.2 Disclosure of Accounting Treatment

Where in the preparation of financial statements, a treatment different from that prescribed in an Accounting Standard has been followed, the fact shall be disclosed in the financial statements, together with the management's explanation as to why it believes such alternative treatment is more representative of the true and fair view of the underlying business transaction in the Corporate Governance Report.

7.9.4.3 Board Disclosures: Risk Management

The company shall lay down procedures to inform board members about the risk assessment and minimization procedures. These procedures shall be periodically reviewed to ensure that executive management controls risk through means of a properly defined framework.

7.9.4.4 Proceeds from Public Issues, Rights Issues, Preferential Issues, Etc.

When money is raised through an issue (public issues, rights issues, preferential issues, etc.), it shall disclose to the audit committee, the uses/applications of funds by major category (capital expenditure, sales and marketing, working capital, etc.), on a quarterly basis as a part of their quarterly declaration of financial results. Further, on an annual basis, the company shall prepare a statement of funds utilized for purposes other than those stated in the offer document/prospectus/notice and place it before the audit committee. Such disclosure shall be made only till such time that the full money raised through the issue has been fully spent. This statement shall be certified by the statutory auditors of the company. The audit committee shall make appropriate recommendations to the board to take-up steps in this matter.

7.9.4.5 Remuneration of Directors

(i) All pecuniary relationship or transactions of the nonexecutive directors vis-à-vis the company shall be disclosed in the annual report.
(ii) Further the following disclosures on the remuneration of directors shall be made in the section on the corporate governance of the annual report:

(a) All elements of remuneration package of individual directors summarized under major groups, such as salary, benefits, bonuses, stock options, and pension.
(b) Details of fixed component and performance linked incentives, along with the performance criteria.
(c) Service contracts, notice period, and severance fees.
(d) Stock option details, if any – and whether issued at a discount as well as the period over which accrued and over which exercisable.

(iii) The company shall publish its criteria of making payments to nonexecutive directors in its annual report. Alternatively, this may be put up on the company's website and reference drawn thereto in the annual report.
(iv) The company shall disclose the number of shares and convertible instruments held by nonexecutive directors in the annual report.
(v) Nonexecutive directors shall be required to disclose their shareholding (both own and held by/for other persons on a beneficial basis) in the listed company in which they are proposed to be appointed as directors, prior to their appointment. These details should be disclosed in the notice to the general meeting called for appointment of such director.

7.9.4.6 Management

(i) 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 and Analysis should include discussion on the following matters within the limits set by the company's competitive position:

(a) Industry structure and developments
(b) Opportunities and threats
(c) Segment-wise or product-wise performance
(d) Outlook
(e) Risks and concerns
(f) Internal control systems and their adequacy
(g) Discussion on financial performance with respect to operational performance.
(h) Material developments in human resources/industrial relations front, including number of people employed

(ii) Senior management shall make disclosures 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 (e.g., dealing in company shares, commercial dealings with bodies, which have shareholding of management and their relatives).

Explanation: For this purpose, the term "senior management" shall mean personnel of the company who are members of its core management team excluding the board of directors.

This would also include all members of management one level below the executive directors including all functional heads.

7.9.4.7 Shareholders

(i) In case of the appointment of a new director or reappointment of a director, the shareholders must be provided with the following information:

  (a) A brief resume of the director
  (b) Nature of his expertise in specific functional areas
  (c) Names of companies in which the person also holds the directorship and the membership of Committees of the board
  (d) Shareholding of nonexecutive directors as stated in Clause 49 (IV) (E) (v) above

(ii) Quarterly results and presentations made by the company to analysts shall be put on company's website or shall be sent in such a form so as to enable the stock exchange on which the company is listed to put it on its own website.

(iii) A board committee under the chairmanship of a nonexecutive director shall be formed to specifically look into the redressal of shareholder and investors complaints like transfer of shares, nonreceipt of balance sheet, nonreceipt of declared dividends, etc. This Committee shall be designated as "Shareholders/ Investors Grievance Committee."

(iv) To expedite the process of share transfers, the board of the company shall delegate the power of share transfer to an officer or a committee or to the registrar and share transfer agents. The delegated authority shall attend to share transfer formalities at least once in a fortnight.

7.9.5 CEO/CFO Certification

The CEO, i.e., the managing director or manager appointed in terms of the Companies Act, 1956, and the CFO, i.e., the whole-time finance director or any other person heading the finance function discharging that function shall certify to the board that:

(a) They have reviewed financial statements and the cash flow statement for the year and that to the best of their knowledge and belief:

  (i) These statements do not contain any materially untrue statement or omit any material fact or contain statements that might be misleading.
  (ii) These statements together present a true and fair view of the company's affairs and are in compliance with existing accounting standards, applicable laws, and regulations.

(b) There are, to the best of their knowledge and belief, no transactions entered into by the company during the year which are fraudulent, illegal, or violative of the company's code of conduct.
(c) They accept responsibility for establishing and maintaining internal controls and that they have evaluated the effectiveness of the internal control systems of the company and they have disclosed to the auditors and the audit committee, deficiencies in the design or operation of internal controls, if any, of which they are aware and the steps they have taken or propose to take to rectify these deficiencies.
(d) They have indicated to the auditors and the audit committee:

 (i) Significant changes in internal control during the year
 (ii) Significant changes in accounting policies during the year and that the same have been disclosed in the notes to the financial statements
 (iii) Instances of significant fraud of which they have become aware and the involvement therein, if any, of the management or an employee having a significant role in the company's internal control system

Corporations are the prominent players in the global markets. They are mainly responsible for generating majority of economic activities in the world, ranging from goods and services to capital and resources. The essence of corporate governance is in promoting and maintaining integrity, transparency, and accountability in the management of the company as well as in manifestation of the values, principles, and policies of a corporation.

Many efforts are being made, both at the center and the state level, to promote adoption of good corporate governance practices, which are the integral element for doing and managing business. However, the concepts and principles of good governance are still not clearly known to the Indian business setup.

Hence, there is a greater need to increase awareness among entrepreneurs about the various aspects of corporate governance. There are some of the areas that need special attention, namely:

- Quality of audit, which is at the root of effective corporate governance
- Role of board of directors as well as accountability of the CEOs and CFOs
- Quality and effectiveness of the legal, administrative and regulatory framework, etc.

7.9.6 Conclusion

That is, it is necessary to provide the corporate desired level of comfort in compliance with the code, principles, and requirements of corporate governance as well as provide relevant information to all stakeholders regarding the performance, policies, and procedures of the company in a transparent manner. There should be proper financial and nonfinancial disclosures by the companies, such as about remuneration package, financial reporting, auditing, and internal controls.

The Main Constituents of Good Corporate Governance are:

1. *Role and Powers of the Board:* The foremost requirement of good corporate governance is the clear identification of powers, roles, responsibilities, and accountability of the board, CEO, and the chairman of the board.
2. *Legislation:* A clear and unambiguous legislative and regulatory framework is fundamental to effective corporate governance.
3. *Code of Conduct:* It is essential that an organization's explicitly prescribed code of conduct is communicated to all stakeholders and is clearly understood by them. There should be some system in place to periodically measure and evaluate the adherence to such code of conduct by each member of the organization.
4. *Board Independence:* An independent board is essential for sound corporate governance. It means that the board is capable of assessing the performance of managers with an objective perspective. Hence, the majority of board members should be independent of both the management team and any commercial dealings with the company. Such independence ensures the effectiveness of the board in supervising the activities of management as well as make sure that there are no actual or perceived conflicts of interests.
5. *Board Skills:* In order to be able to undertake its functions effectively, the board must possess the necessary blend of qualities, skills, knowledge, and experience so as to make quality contribution. It includes operational or technical expertise, financial skills, legal skills, as well as knowledge of government and regulatory requirements.
6. *Management Environment:* It includes setting up of clear objectives and appropriate ethical framework, establishing due processes, providing for transparency and clear enunciation of responsibility and accountability, implementing sound business planning, encouraging business risk assessment, having right people and right skill for jobs, establishing clear boundaries for acceptable behavior, establishing performance evaluation measures, and evaluating performance and sufficiently recognizing individual and group contribution.
7. *Board Appointments:* To ensure that the most competent people are appointed in the board, the board positions must be filled through the process of extensive search. A well-defined and open procedure must be in place for reappointments as well as for appointment of new directors.
8. *Board Induction and Training: It* is essential to ensure that directors remain abreast of all development, which are or may impact corporate governance and other related issues.
9. *Board Meetings: These* are the forums for board decision making. These meetings enable directors to discharge their responsibilities. The effectiveness of board meetings is dependent on carefully planned agendas and providing relevant papers and materials to directors sufficiently prior to board meetings.
10. *Strategy Setting:* The objective of the company must be clearly documented in a long-term corporate strategy including an annual business plan together with achievable and measurable performance targets and milestones.

11. *Business and Community Obligations:* Though the basic activity of a business entity is inherently commercial, yet it must also take care of community's obligations. The stakeholders must be informed about the approval by the proposed and ongoing initiatives taken to meet the community obligations.
12. *Financial and Operational Reporting:* The board requires comprehensive, regular, reliable, timely, correct, and relevant information in a form and of a quality that is appropriate to discharge its function of monitoring corporate performance.
13. *Monitoring the Board Performance:* The board must monitor and evaluate its combined performance and also that of individual directors at periodic intervals, using key performance indicators besides peer review.
14. *Audit Committee: It* is inter alia responsible for liaison with management and internal and statutory auditors, reviewing the adequacy of internal control and compliance with significant policies and procedures, reporting to the board on the key issues.
15. *Risk Management:* Risk is an important element of corporate functioning and governance. There should be a clearly established process of identifying, analyzing, and treating risks, which could prevent the company from effectively achieving its objectives. The board has the ultimate responsibility for identifying major risks to the organization, setting acceptable levels of risks, and ensuring that senior management takes steps to detect, monitor, and control these risks.

7.10 Case Study Two: The Satyam Episode in India

The case examines the corporate governance issues at the India-based IT services company, Satyam Computer Services Limited (Satyam). In mid-December 2008, Satyam announced acquisition of two companies: Maytas Properties and Maytas Infrastructure owned by the family members of Satyam's founder and Chairman Ramalinga Raju (Raju). Due to adverse reaction from institutional investors and the stock markets, the deal was withdrawn within 12 h. Questions were raised on the corporate governance practices of Satyam with analysts and investors questioning the company's board on the reasons for giving consent for the acquisition as it was a related party transaction.

After the deal was aborted, four of the prominent independent directors resigned from the board of the company. In early January 2009, Raju revealed that the revenue and profit figures of Satyam had been inflated for past several years. The revelation further deepened concerns about poor corporate governance practices at the company. The case describes the corporate governance structure at Satyam, its code of conduct, roles and responsibilities of different committees under the board, whistle-blower policy, etc. It highlights the role played by the independent directors of Satyam in approving the Maytas deal and discusses their limitations.

7.11 Case Study Three: UTI Scam

Of all the recent encounters of the Indian public with the much-celebrated forces of the market, the Unit Trust's US-64 debacle is the worst. Its gravity far exceeds the stock market downswing of the mid-1990s, which wiped out Rs. 20,000 crores in savings. The debacle is part of the economic slowdown which has eliminated one million jobs and also burst the information technology (IT) bubble.

This has tragically led to suicides by investors. And then suspension of trading in US-64 made the hapless investors more dejected at the sinking of this "supersafe" public sector instrument that had delivered a regular return since 1964. There is a larger lesson in the US-64 debacle for policies towards public savings and public sector undertakings (PSUs). The US-64 crisis is rooted in plain mismanagement. US-64 was launched as a steady income fund. Logically, it should have invested in debt, especially low-risk fixed-income government bonds. Instead, its managers increasingly invested in equities, with high-risk speculative returns. In the late 1980s, UTI was "politicized" with other financial institutions (FIs) such as LIC and GIC and made to invest in certain favored scrips. By the mid-1990s, equities exceeded debt in its portfolio.

The FIs were also used to "boost the market" artificially as an "endorsement" of controversial economic policies. In the past couple of years, UTI made downright imprudent but heavy investments in stocks from Ketan Parekh's favorite K-10 portfolio, such as Himachal Futuristic, Global Tele, and DSQ. These "technology" investments took place despite indications that the "technology boom" had ended. US-64 lost half its Rs. 30,000 crore portfolio value within a year. UTI sank Rs. 3,400 crores in just six out of a portfolio of 44 scrips.

This eroded by 60 %. Early that year, US-64's net asset value plunged below par (Rs. 10). But it was repurchasing US-64 above Rs. 14! Today, its NAV stands at Rs. 8.30 – a massive loss for 13 million unit-holders. It is inconceivable that UTI made these fateful investment decisions on its own.

According to insiders, the Finance Ministry substantially influenced them: all major decisions need high-level political approval. Indeed, collusion between the FIs, and shady operators like Harshad Mehta, was central to the Securities Scam of 1992. The Joint Parliamentary Committee's report documents this. In recent months, the Finance Ministry became desperate to reverse the post-budget market downturn.

UTI's misinvestment now coincided with the global technology "meltdown." US-64 crashed. UTI chairman resigned. Although culpable, he was probably a scapegoat too.

The Ministry has kept a close watch on UTI, especially since 1999. The US-64 debacle, then, is not just a UTI scam. It is a governance scam involving mismanagement by a government frustrated at the failure of its macroeconomic calculations. This should have ensured the finance minister's exit in any democracy which respects parliamentary norms.

There are larger lessons in the UTI debacle. If a well-established, and until recently well-managed, institution like UTI cannot safeguard public savings, then we should *not allow the most precious of such savings – pensions – to be put at risk. Such risky investment is banned in many self avowedly capitalist European economies.*

In India, the argument acquires greater force given the poorly regulated, extremely volatile, stock market – where a dozen brokers control 90 % of trade. Yet, there is a proposal by the Finance Ministry to privatize pensions and provident funds. Basically, the government, deplorably, wants to get rid of its annual pension obligation of Rs. 22,000 crores.

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