

**LAWFOYER INTERNATIONAL**  
**JOURNAL OF DOCTRINAL LEGAL**  
**RESEARCH**  
**(ISSN: 2583-7753)**

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Volume 2 | Issue 1

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2024

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# CORPORATE GOVERNANCE PRACTICES IN INDIA: A THEORETICAL ASPECT

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## I. ABSTRACT

In this article, the author endeavours to delve into the evolution of corporate governance in India post the enactment of the Companies Act of 2013. This critical legislation introduced several key provisions aimed at strengthening transparency, accountability, and fairness in corporate entities. In this article, the author discusses and highlights the importance of notable changes, including the restructuring of board compositions, the designation of Key Managerial Persons (KMPs), the revised criterion for the appointment of the company's auditor, and the establishment of essential committees within the prescribed class of companies, such as the audit committee, stakeholder relationship committee, nomination and remuneration committee, and corporate social responsibility committee while highlighting its impact on corporate governance. The author also highlights other measures introduced in addition to these changes to enhance governance, such as mandatory disclosure of directors' interests, the creation of vigil mechanisms, tighter control over related party transactions, and the introduction of internal and secretarial audit requirements. Hence the Companies Act of 2013 significantly contributes to creating a more transparent, accountable, and fair corporate landscape.

## II. KEYWORDS:

Corporate Governance, Auditor, Independent Director, KMPs, Transparency, Accountability

## III. INTRODUCTION

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Corporate governance practices mean a set of rules, regulations and standards prescribed by laws or otherwise adopted by the companies in accordance with the laws in force according to which a company is controlled and directed.<sup>2</sup> Corporate governance in India remains essential to improve the performance of companies and the degree of accountability, as well as promote fair play, transparency, and accountability to curb the failure of companies.<sup>3</sup> As the Indian economy has proliferated since the introduction of LPG reforms,<sup>4</sup> corporate governance practices also witnessed a paradigm shift.<sup>5</sup> The corporate governance practices until 2013 supported the economy's growth, albeit remaining vulnerable to widespread corruption and administrative delays. <sup>6</sup>The Act of 2013 is immaculate in so far as it covers and enforces the ignored nuances of corporate governance in a strict manner in awe to ensure fair play and, furthermore, protect the interest and rights of the shareholders.<sup>7</sup>

In 2013, with the advent of the Companies Act, 2013 the regulatory framework establishing the foundation of corporate governance was substantially improved.<sup>8</sup> The Act of 2013, in spirit, tends to promote corporate democracy while aggrandising transparency and accountability in the corporate realm.<sup>9</sup> The Act of 2013 lays a strong and sturdy foundation for good corporate governance by establishing a holistic framework, ensuring effectual and efficacious management of the companies by the board of directors comprising newly added independent directors and other

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<sup>2</sup> Todorović, I., 2013. Impact Of Corporate Governance On Performance Of Companies. *Montenegrin journal of economics*, 9, pp. 47-54.

<sup>3</sup> Gupta, R. (2016b). Corporate Governance In India – An Overview. *Legal Research Development: An International Refereed e-Journal*, 1(II), pp.16-32. doi:<https://doi.org/10.53724/lrd/v1n2.04>.

<sup>4</sup> Mangal, S., & Agarwal, D., 2012. GDP Composition and Sector-wise Growth Trends in India: Evidences from Post-Reform Period. *Norwegian School of Economics*.

<sup>5</sup> .Narayanaswamy, R., Raghunandan, K. and Rama, D.V. (2012d). Corporate Governance in the Indian Context. *Accounting Horizons*, 26(3), pp.583-599. doi:<https://doi.org/10.2308/acch-50179>.

<sup>6</sup>Chakrabarti, R., Megginson, W. and Yadav, P.K. (2008b). Corporate Governance in India. *Journal of Applied Corporate Finance*, 20(1), pp.59-72. doi:<https://doi.org/10.1111/j.1745-6622.2008.00169.x>.

<sup>7</sup> VIJAY, Gee. (2011). Corporate Governance Under the Companies ACT 2013: A More Responsive System of Governance. *Indian Journal of Applied Research*, 4(4), pp.1-3. doi:<https://doi.org/10.15373/2249555x/apr2014/210>.

<sup>8</sup> Balasubramanian, B.N. (2013). Strengthening Corporate Governance in India - A Review of Legislative and Regulatory Initiatives in 2013. *SSRN Electronic Journal*. doi:<https://doi.org/10.2139/ssrn.2391643>.

<sup>9</sup> Kumar, N., (2014). COMPANIES ACT, 2013: AN ANALYSIS OF KEY RULES. *Sai Om Journal of Commerce & Management: A Peer Reviewed International Journal*, 1, pp. 15-22.

committees such as audit committees mandatorily established by law for a prescribed class of companies.<sup>10</sup> In line with the corporate governance principles provided under the Companies Act, 2013, the Security and Exchange Board of India (SEBI) brought amendments, such as amendment to Clause 49 of the Listing Agreement along with other enactments, to give teeth and meaning to good governance practices within the fold of the Act. It has been observed that the Indian companies have remained compliant with the amended clause 49 of the listing agreement insofar as the disclosure requirements are concerned, owing to the enhanced penalties levied on non-compliance, thereby, strengthening good governance.<sup>11</sup>

Further in this article, the changes brought in by the Companies Act, 2013, underscoring good corporate governance practices, are discussed in parts.

#### **IV. REVISED COMPOSITION OF BOARD OF DIRECTORS**

The board of directors play a pivotal role in navigating the management of the affairs of a company and serves as an essential element of corporate governance, acting in the company's and its shareholders' best interest.<sup>12</sup> Contemporarily, the law in force mandates the board to have both executive and non-executive directors on the board of the company such that half of these directors are non-executive directors.<sup>13</sup> These non-executive directors include a newly introduced class of directors, as well known as the independent directors, and their existence is considered crucial for good governance in listed companies wherein substantial money invested by the public at large is involved.<sup>14</sup>

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<sup>10</sup>Vyas, S. (2023). Corporate Governance Practices in India: Problems & Importance. *IJFMR - International Journal For Multidisciplinary Research*, [online] 5(3). doi:<https://doi.org/10.36948/ijfmr.2023.v05i03.2801>.

<sup>11</sup> Abraham, S., Marston, C. and Jones, E. (2015). Disclosure by Indian companies following corporate governance reform. *Journal of Applied Accounting Research*, 16(1), pp.114-137. doi:<https://doi.org/10.1108/jaar-05-2012-0042>.

<sup>12</sup> Jan, S., & Sangmi, M., (2016). The Role of Board of Directors in Corporate Governance. *Imperial journal of interdisciplinary research*, 2.

<sup>13</sup> SEBI Regulations 2015, reg17 (1) (a).

<sup>14</sup> Pande, S. and Ansari, V.A. (2015). Board Independence and the Regulatory Framework for Appointing Independent Directors on the Boards of Listed Companies in India. *SSRN Electronic Journal*. doi:<https://doi.org/10.2139/ssrn.2549557>.

For the appointment of Independent directors, a rigorous procedure is followed to ensure that the person appointed as the independent director has no direct or indirect relationship with the company or its affiliates.<sup>15</sup> The law in force also provides an obligation to provide training to the ones appointed as independent directors in order to get them acquainted with the company, their role, power, responsibilities and rights so that they can understand and discharge their functions in a more effective manner as intended by the legislature.<sup>16</sup> The presence of independent directors adds to good governance practices by ensuring a neutral representation on the board of the company, transparency, and a higher degree of accountability.<sup>17</sup>

Prior to 2013, despite compelling evidence suggesting the positive impact of the appointment of women to the board of directors of companies, the representation of Indian women on the board remained low compared to other countries.<sup>18</sup> The new law respects gender diversity and thereby mandates the appointment of a female director on the board of a listed company.<sup>19</sup> Studies have shown that the appointment of women directors to the board of a company yields a positive impact on the overall performance of the company.<sup>20</sup> Therefore, the government's move to reserve representation of women on the board of a listed company remains a good governance practice. However, it is also the case that though the law mandates the representation of a woman on the board of a listed company, it clearly misses out on providing the eligibility criteria. Due to this, in many family-owned firms, the positive impact yielded by virtue of the presence of a woman director on the board gets weakened.<sup>21</sup>

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<sup>15</sup> The Companies Act 2013, s149(6).

<sup>16</sup> Companies Act, 2013 Sch. IV, Listing Agreement, Cl.49 (II) (B) (7) (a) & (b), and SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015, reg25 (7).

<sup>17</sup> Dube, I. and Pakhira, A. (2013). ROLE OF INDEPENDENT DIRECTOR IN CORPORATE GOVERNANCE - REFERENCE TO INDIA. *Corporate Board: role, duties and composition*, 9(1). doi:<https://doi.org/10.22495/cbv9i1art5>.

<sup>18</sup> Kurup, A., Chandrashekar, S. and Muralidharan, K. (2011). Woman power in Corporate India In conversation with Kiran Mazumdar Shaw, Chairperson & MD, Biocon Ltd. *IIMB Management Review*, 23(4), pp.223-233. doi:<https://doi.org/10.1016/j.iimb.2011.08.006>.

<sup>19</sup> The Companies Act, 2013, s149.

<sup>20</sup> Jyothi, P. and Mangalagiri, J. (2019). Would Firm Performance be Better with Women Directors? Evidence from India. *Vision: The Journal of Business Perspective*, 23(2), pp.180-188. doi:<https://doi.org/10.1177/0972262919840217>.

<sup>21</sup> Sarkar, J. and Selarka, E. (2015). Women on Board and Performance of Family Firms: Evidence from India. *SSRN Electronic Journal*. doi:<https://doi.org/10.2139/ssrn.2730551>.

## V. APPOINTMENT OF KMPS

As companies in India are expanding their operations and calling in global investments, the accountability of the company acting through its board of directors has also increased significantly.<sup>22</sup> The increase in responsibility in terms of duties and responsibilities owed towards the company's members has a direct link with corporate governance; hence, the need for a good governance mechanism has also increased.<sup>23</sup> The Companies Act of 2013, beyond providing for the composition of the board of directors, has also addressed the issue pertaining to the appointment of Key Managerial Persons (KMPS) in specific companies,<sup>24</sup> who ought to act in tandem with the board of directors in administering the company's day-to-day affairs.

KMPS are the individuals who actually manage the day-to-day affairs of a company in an executive capacity. The appointment of KMPS serves beyond a mere fulfilment of legal obligation. It goes at length in assisting the board of directors, who, by the law, are under obligations with respect to the matters pertaining to accounting, financial statements, and internal management of the company, including compliance with the laws and by-laws in force.<sup>25</sup> Moreover, the insights and expertise provided by the KMPS culminate in informed decision-making at the meetings, which is crucial for the long-term success of the company. Therefore, besides being a legal obligation calling for compliance, the appointment of KMPS in specific companies aligns with good corporate governance practices.

## VI. APPOINTMENT OF AUDITORS

Audits are conducted to determine the truthfulness and reliability of a company's financial statements and statement of account, which serves as an important factor in alluring investments from investors.<sup>26</sup> The Companies Act, 2013 encumbers all the companies, as is meant within the meaning of Section 2 (10), with an obligation to

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<sup>22</sup> Supra Note 6 at 1.

<sup>23</sup> Ibid.

<sup>24</sup> The Companies Act 2013, s196 & The Companies Act 2013, s204.

<sup>25</sup> The Companies Act, 2013, s134 (5).

<sup>26</sup> Bhide, S., (2017). Accounting and Auditing a part of broader framework of corporate governance: A perspective of Indian Auditors. *TIJ's Research Journal of Social Science & Management - RJSSM*, 7.

appoint an auditor at the first general meeting for a maximum tenure of five years.<sup>27</sup> To uphold the standard and quality of accounting, the law has prescribed the practising chartered accountants as the only class eligible for being appointed as the auditor of a company; in fact, even if a company wishes to appoint an auditing firm to conduct the audit only the chartered accountant partner of such firm under the law is permitted to act and sign audit reports on behalf of the firm.<sup>28</sup>

To ensure impartiality and fairness in the accounting process, the auditors are even prohibited from rendering certain services to the company, including its holding, subsidiary and associate companies to which they are appointed.<sup>29</sup> Further, audit rotation requirements require listed companies, unlisted public companies having a paid-up share capital of Rs. Ten Crores or more, private companies with a paid-up share capital of Rs. Fifty Crores or more, along with unlisted public companies and private limited companies not crossing the threshold limit of the abovementioned paid-up share capital having public borrowings of Rs. Fifty Crores or more to mandatorily rotate the individual auditors after 5 years and auditing firms after ten years, making both ineligible for being appointed as the auditor of the same company for the next five years.<sup>30</sup>

## VII. FORMATION OF VARIOUS COMMITTEES

The Companies Act, 2013 has expanded the scope of the erstwhile legal framework providing for the formation, regulation and functioning of various committees within specified classes of companies.<sup>31</sup> These include the audit committee, stakeholder relationship committee, nomination and remuneration committee and corporate social responsibility committee.<sup>32</sup>

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<sup>27</sup> The Companies Act 2013, s139 (1).

<sup>28</sup> The Companies Act 2013, s141 (1).

<sup>29</sup> The Companies Act 2013, s144.

<sup>30</sup> The Companies Act 2013, s139 (2), and Companies (Audit & Auditors) Rules 2014, r5.

<sup>31</sup> Karavadi, A.K. (2014). *committees under the Companies Act 2013*. [online] lakshmisri.com. Available at: <https://www.lakshmisri.com/insights/articles/committees-under-the-companies-act-2013#> Accessed 31 March, 2024.

<sup>32</sup> Ibid.

The audit committee is vital in ensuring fairness, transparency, and accountability in the company's functioning and upholding good governance practices. The new company law, in contradistinction to the erstwhile law, provides details regarding the composition of the committee and the specific roles entrusted to it.<sup>33</sup> To uphold the committee's independence, the law prescribes the appointment of a minimum of three directors, wherein there shall be a majority of independent directors.<sup>34</sup> Further, to ensure that the directors nominated to the auditing committee can carry out the functions entrusted to them in an efficacious manner, the ability to comprehend and understand a financial remains a precondition for appointment.<sup>35</sup>

Other committees, apart from the audit committee, also play a vital role in enhancing the board of directors' effectiveness by supplying substantial expertise required for good governance.<sup>36</sup> The stakeholders' relationship committee comes into the picture as a company reaches 1000 or more security holders in a financial year; this committee plays a vital role in redressing the grievances of the shareholders and fostering a communication medium between the board and the company's shareholders.<sup>37</sup> The nomination and remuneration committee is entrusted with the duty to recommend members suitable for directorship, formulating policies for regulating the terms of their appointment and remunerations along with evaluating the performance of the KMPs of the company; this committee thrives in its function to ensure transparency and non-arbitrariness in dispensing remunerations among the executives.<sup>38</sup> The setting up of a corporate social responsibility (CSR) committee depends on the applicability of the CSR provisions over a particular company; the committee, if so formed, goes a length in giving meaning and teeth to the CSR by supervising the CSR activities and ensuring compliance with the legal obligations.<sup>39</sup>

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<sup>33</sup> The Companies Act 2013, s177.

<sup>34</sup> Ibid.

<sup>35</sup> Ibid.

<sup>36</sup> Doshi, V.J. (2013). *Different Committees as per the Companies Act, 2013*. [online] CAclubindia. Available at: <https://www.caclubindia.com/articles/different-committees-as-per-the-companies-act-2013-19008.asp> Accessed 30 Mar. 2024.

<sup>37</sup> The Companies Act 2013, s178.

<sup>38</sup> Ibid.

<sup>39</sup> The Companies Act 2013, s135.

## VIII. OTHER PROVISIONS FOR GOOD CORPORATE GOVERNANCE

The new Companies Act of 2013 underscores good corporate governance practices through numerous provisions. The law, beyond setting up various committees, laying a procedure for appointing auditors and independent directors and determining the composition of the company's board, entails a set of practices that ought to be followed by the companies to promote good governance. These practices are as follows:

Disclosure of Interest by the Directors: Upon appointment, a director is mandated by law to make disclosures regarding their interest in the company to which they are appointed.<sup>40</sup> Subsequent to the appointment as director, they are also required to make annual disclosures regarding the same.<sup>41</sup> This brings transparency to the board as well as ensures independence in the case of independent directors.

Vigil Mechanism: Legal imposition on all listed companies and other specified companies to establish and incorporate a vigil mechanism to enable the members of the company to raise genuine concerns.<sup>42</sup> The law even opens the door to the chairman of the audit committee if a member raises concerns regarding some malpractices going on in the company, thereby assuring protection and precluding victimisation of the whistleblower.<sup>43</sup>

Related Party Transactions: The law also imposes an obligation on the company to refrain from entering into related party transactions without the due approval of the board.<sup>44</sup> Here, the audit committee plays a vital role, as in applicable cases, it is empowered to make an omnibus approval for such related party transactions.<sup>45</sup> Moreover, suppose in case a director or employee of a company enters into a transaction valued at any amount less than One Crore Rupees without the due approval of the committee or ratification of such transaction within three months of

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<sup>40</sup> The Companies Act 2013, s184.

<sup>41</sup> Ibid.

<sup>42</sup> The Companies Act 2013, s177 (9).

<sup>43</sup> Ibid.

<sup>44</sup> The Companies Act 2013, s188.

<sup>45</sup> The Companies Act 2013, s177 (4).

the transaction. In that case, such a transaction is voidable at the option of the committee.<sup>46</sup>

Internal and Secretarial Audits: Certain classes of companies, in addition to the statutory audit, are required to conduct internal audits; such audits can be conducted by practising chartered accountants, cost accountants, and other specified individuals.<sup>47</sup> Further, all listed companies and certain classes of companies are also required to annex a secretarial audit report from a practising company secretary along with the report of the board.<sup>48</sup>

## IX. CONCLUSION

The author avers that the Companies Act 2013, in theory, serves as a landmark legislation for India's corporate governance practices. As discussed, the Act has brought in substantial changes, including a change in the composition of the board of directors, laying procedure for appointment of KMPs, establishing a strict eligibility criterion for being appointed as auditor of the company, and mandating the formation of various committees as per applicability. This helps in establishing a check and balance mechanism, and precluding instances of corporate frauds and scandals. Furthermore, the Act includes provisions such as mandatory disclosure of director interests, institutionalization of vigil mechanisms, regulation of related party transactions, and requirements for internal and secretarial audits, which strengthen corporate governance practices by instilling a higher degree of transparency in the process. In the opinion of the author, the Companies Act of 2013 sets a solid foundation for building a corporate environment characterized by integrity, responsibility, and ethical conduct. It is, therefore, in light of the abovementioned submitted that, in theory, the Companies Act 2013 has served as a monumental legislation regulating and strengthening the corporate governance practices in India.

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<sup>46</sup> Ibid.

<sup>47</sup> The Companies Act 2013, s138.

<sup>48</sup> The Companies Act 2013, s204.