# Governance norms for government companies : an analysis

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# Introduction

A good corporate governance practice means creating transparent rules, having good leadership, and aligning the interests of shareholders, directors, and management. Corporate governance makes sure that the company's goals are centred on generating long-term value and are consistent with moral principles. It means protecting minority shareholders, ensuring accountability of the Board of Directors (simply called 'the Board') and management of the company, timely reporting, and adequate disclosures. Responsible management and control of businesses will result from following excellent corporate governance standards, which include abiding by a set of guidelines, procedures, and practices.

## Government company

A corporation is classified as a government company if any level of government, federal or state, owns more than 51% of its total shares. For example, Hindustan Machine Tools Limited, Coal India Limited, Indian Oil Corporation Limited, and Steel Authority of India Limited are government companies. All government companies fall under the purview of PSU.

### Applicability of governance norms

The state or central government may invest in an enterprise, making it a public sector enterprise/undertaking (PSE/PSU). These are subject to stringent governance norms applicable to private-sector companies and more. Both listed and unlisted PSEs will be subjected to those norms, rules, guidelines, etc.

### Distribution companies

Many distribution companies (DISCOMs) that supply electricity are also government companies. Many states have state electricity boards. These companies are also subject to those regulations like any other government company. However, their regulatory bodies are different. State Electricity Regulatory Commissions (SERCs) and the Central Electricity Regulatory Commission (CERC) oversee their operations.

# Methods of governance : laws, rules, and regulations

There is a need to set up clear and comprehensive regulations:

## Companies Act, 2013

The Companies Act of 2013, replacing the old Act of 1956, provides a formal structure for corporate governance by enhancing disclosures, reporting, and transparency. It also introduced new concepts such as performance evaluation of the board, committee, and individual directors. Additionally, associate and joint venture corporations were added to the definition of "subsidiary." Sections 394 and 395 of Chapter XXIII talk about government companies. It says that government companies are required to prepare an annual report on the workings and affairs of that company. Three months from the date of the annual general meeting, it must be prepared. If the report is on a central government company, a copy of it is brought before both Houses of Parliament with the remarks made by the Comptroller and Auditor-General. If it is a state government company, the two will be presented before the Houses of the State Legislature.

Government companies are also subjected to Section 135. If they satisfy any one of the thresholds of a net worth of Rs. 500 crore or more, a minimum net profit of Rs. 5 crore, and a minimum turnover of Rs. 1,000 crore prescribed in the Act, they have to engage in corporate social responsibility (CSR) activities. They are mandated to spend 2% of the average net profit generated in the preceding three financial years.

## Right To Information (RTI) Act

This Act enables citizens to demand information regarding the conduct of business by the government companies as and when they require it.

## Other Acts

These are some other legislations that have a bearing on the corporate governance principles: the Competition Act, 2002; the Foreign Exchange Management Act, 1999; and the Industries (Development and Regulation) Act, 1951.

## Companies Rules

The Companies Act and Rules have incorporated various provisions focused on strengthening corporate governance in companies in India. Rules are as follows:

- The Companies (Appointment and Qualification of Directors) Rules, 2014,
- The Companies (Meetings of Board and its Powers) Rules, 2014,
- The Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014,

- The Companies (Accounts) Rules, 2014,
- The Companies (Audit and Auditors) Rules, 2014,
- The Companies (Corporate Social Responsibility Policy) Rules, 2014,
- The Companies (Management and Administration) Rules, 2014.

All these rules are made to ensure that companies have the required degree of corporate governance.

## Security Exchange Board of India (SEBI) (Listing Obligations & Disclosure Requirements) Regulations, 2015

SEBI implemented several regulations and guidelines to increase transparency and accountability in corporate governance-related matters. SEBI provides, monitors, and regulates the corporate governance norms for listed companies through Clause 49. In 2014, they were strengthened to conform to the 2013 Companies Act.

Clause 49 further states that the holding company's subsidiary companies will be subject to the same legislation and auditing standards. At least one independent director of the holding company must be on the board of the subsidiary company.

## Committees

The importance of corporate governance came to be realised with the report of the Kumar Mangalam Birla Committee set up by SEBI in 2000. In 2002, the Naresh Chandra Committee was set up by the Ministry of Finance. In 2003, the Narayana Murthy Committee was set up by SEBI.

These three committees also recommended the constitution, composition, powers, and functions of the audit committee. As per Section 177 of the Companies Act of 2013, read with Rule 6 of the Companies (Meetings of Board and its Powers) Rules, 2014, every listed company and all other public companies with paid-up capital of Rs. 10 crores or more or having turnover of 100 crores or more, or having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding Rs. 50 crore or more, to have an Audit Committee which will have a minimum of three directors and as many additional directors as the Board deems necessary, with two thirds of the overall membership being directors (not managing or full-time directors). The Audit Committee's responsibilities are expanded by the revised Clause 49, which includes reviewing and managing related party transactions of the company, strengthening internal audit and control systems, supervising the company's risk management policies and programs, ensuring that anti-fraud and vigil mechanisms are effective, and ensuring transparency and accuracy of financial reporting and disclosures.

## Department of Public Enterprises (DPE) guidelines

DPE conducts surveys to collect information on various Central Public Sector Enterprises (PSE), and it continues to maintain them in the name of the Public Enterprises Survey. DPE evaluates and monitors the performance of PSEs (including the Memorandum of Understanding mechanism), which is laid down annually before the Parliament during the Budget Session. Additional eligibility criteria had to be met by the CPSEs to get excellent ratings. Efficiency parameters were also incorporated.

In March 2010, many mandatory guidelines were issued on corporate governance for all CPSEs about the board composition of CPSEs, the audit committee, the remuneration committee, subsidiary companies, disclosures, the code of conduct and ethics, audit of accounts, risk management, and reporting. Different board committees are constituted to keep oversight of or review transactions or management decisions.

### Independent directors on the board

Desirable Corporate Governance Code by CII (1998) was the first to introduce the concept of independent directors. DPE sought to put checks and balances in place by adding an essential requirement. The inclusion of the minimum prescribed number of non-official (independent) directors in the board. For unlisted CPSEs, they must comprise at least one-third of the Board, and for listed CPSEs, half. They are appointed based on the recommendation of a search committee and with the approval of ACC/DoPT (Department of Personnel and Training). These directors have to be on the audit and remuneration committees, as well as serving as their chairs. The audit committee's independent directors are responsible for overseeing the company's ethical and compliance protocols, which includes evaluating the efficiency of the whistleblower mechanism.

### Transparency & Disclosures

Government companies have stricter disclosure norms as they have to publicly disclose detailed annual reports like financial reports, performance reports, corporate social responsibility activities, and other operational data. Even information about institutional investors, the list of companies they hold shares in, their voting records, and their reasons for assenting or dissenting to any of the Board Resolutions are also to be disclosed to the public. Clause 49 also mentions remuneration and stock option plans granted to these non-executive directors will have to be disclosed in the annual report of the company.

### Protection of minority shareholders

Measures are to be taken to ensure that the interests of minority shareholders are protected and the executive management does not misuse the position to syphon off or funnel funds from the business via related party transactions or transactions of significant value involving preferred suppliers or clients.

### Performance evaluation

Government companies undergo stringent performance evaluations to assess their achievements against the targets set by the government through the Memorandum of Understanding (MoUs).

## Public procurement norms

Public procurement means all the dealings that government companies may make with private players, contractors, or companies to procure or gain any goods or services from them. They get involved when the government feels there is a need for them to improve efficiency, competition, and accountability.

Government companies must adhere to strict public procurement norms that emphasise fairness, transparency, and competitive bidding processes. The dealings must be ethical and fair, competition must be open and effective, and everything must promote the equity principle. Since the government ultimately answers to the people, the bidding process must be fair, and the contract cannot be awarded to the lowest bidder by default.

# Monitoring authorities

Government companies are subjected to multi-layered, intense oversight, which is more than in private companies.

## Central Vigilance Commission (CVC)

Government companies are required to be under tighter vigilance to prevent any political interference, corruption, fraud, ethical lapses, inefficiencies, and irregularities. To do this, government companies are required to appoint Chief Vigilance Officers in adherence to the guidelines issued by the CVC.

## Department of Public Enterprises (DPE)

It monitors government companies to see how far they have been compliant with its guidelines. It exercises administrative control to provide policy framework and oversight to the PSEs.

## Comptroller and Auditor General (CAG) of India

CAG conducts rigorous audits and adds comments or findings before the audit report goes to Parliament. CAG also keeps an eye on the companies' functioning and performance.

## Parliament and state legislature

Parliamentary committees and state legislative committees periodically review the performance of the central or state government companies when the audit reports appear before both the

Houses. Being accountable to parliament indirectly makes them responsible before the President of India as well.

## Investors

If there is anyone else investing in the government companies, if there is any collaborating partner, the government companies need to report to them, inform, and disclose any information they may require in the present or in the future, which may be a part of due diligence for them. Institutional investors actively take part in AGMs and have voting rights. They have the freedom and power to assent or dissent from any Board decisions.

# Measuring corporate governance practices

When discussing the measuring of corporate governance practices, it is important to discuss the corporate governance scorecard.

## Corporate governance scorecard

### Issues

There was no comprehensive tool for determining how compliant a company was in fulfilling its corporate governance requirements. Companies couldn't self-assess their corporate governance status as against the other companies. Investors would have no idea about the CG status of the companies.

### Result

To solve these issues, the Bombay Stock Exchange (BSE) developed a CG scorecard for Indian corporations. BSE achieved this by collaborating with International Finance Corporation (IFC) Washington, a member of the World Bank Group. This collaboration was announced on 4th February 2016.

The CG scorecard provides investors with a standardised measure of the corporate governance status of any company. It is developed based on four principles of the Organisation for Economic Co-operation and Development (OECD);

1. Enforcing rights and equitable treatment of shareholders
2. Role of stakeholders
3. Disclosures and transparency
4. Responsibilities of the Board of Directors

Giving a total of 100%, each principle was given 30% weightage with the exemption of the ‘Role of stakeholders’, which had 10% weightage. This scorecard enables companies to get a better picture of the quality of corporate governance practices they have and where they need to

improve. The CG Scorecard helped companies understand their strengths and weaknesses in corporate governance practices. Companies had to stay on their toes and be aware of what practices were adopted by companies across the globe to meet that standard.

Companies self-assess themselves by answering a set of questions based on these principles. The results are duly verified by the impanelled verifying agencies. The total score obtained out of 100 can be used by the investors as an important factor in making investment decisions.

### Awards

Apart from obtaining good scores on the scorecard, government companies are recognised and awarded for their compliance with corporate governance norms by giving them PSU awards and Institute of Company Secretaries of India (ICSI) Awards.

# Reality of Public Sector Undertakings (PSUs)

## IIAS Report

An analysis of BSE 100 companies revealed that 93 companies were compliant, and the remaining 7 non-compliant ones were PSUs. The board structure is weak, with an inadequate number of independent directors. The government exempts many paper-based corporate governance requirements from applying to the PSUs. Given that the government controls these entities, there's potential for interference in decision-making and appointments, undermining independent oversight and accountability.

## Corporate Social Responsibility (CSR)

As per available information for the year 2014-2015, the amount spent by 121 Central Public Sector Enterprises (CPSEs) was Rs. 2,443 crores. However, the calculated amount that ideally should have been used by these 121 CPSEs was Rs. 3,479.8 crore towards CSR activities.

## Security Exchange Board of India (SEBI)

PTC India Financial Services Limited is said to have never paid the SEBI penalties for its non-compliance with its Listing and Disclosure Obligation Regulations.

## Comptroller and Auditor General (CAG) Audit

Additionally, a 2023 CAG Compliance Audit revealed weak governance throughout PSUs. It identified notable companies like National Mineral Development Corporation, Coal India, Oil and Natural Gas Corporation, and Steel Authority of India Limited amongst the 72 listed PSUs that violated corporate governance norms for not having an adequate number of independent directors on the Board.

## Corporate Governance Scorecard

In 2023, 64 out of BSE 100 companies have achieved the ‘Good’ or ‘Leadership’ category, 12 more than last year. This has shown that despite poor governance trends among PSUs, government companies have shown improvement.

# Conclusion

Despite being a part of PSUs’ wide umbrella, government companies in India have shown their potential to become greater and more efficient. The government needs to be more accountable and enforce even more stringent norms to ensure PSUs also comply. Only with a strong, socially responsible government and its corporations can a nation have its much-needed economic development.

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