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INDIA'S CURRENT CORPORATE GOVERNANCE PRACTICES – IMPACT & CHALLENGES

- Prashanth Sabeshan[1] and Sindhu V. Reddy[2]

ABSTRACT

Corporate governance has been given different definitions by different experts and has been continuously recognized as one of the primary factors which affects the performance of a company in the long run. It is one of the most important factors which investors consider in a company. In light of the above, we have looked at following questions in detail in the course of this article, i.e.:

1. Is corporate governance essential for companies?
2. Is corporate governance an impediment to growth? and
3. Is the current legal regime with respect to corporate governance in India, functioning adequately at the practical level and does it take into account the interests of all the stakeholders affected by it?

In the course of finding the answers to the above questions, the article discusses various relevant issues faced by companies with respect to compliance with corporate governance norms in multiple jurisdictions, the inter mingling between private equity sector and corporate governance, the need for changing the law relating to whistle-blowers, insider trading, forensic audit and the enforcement framework prevalent against corporates in India. The article concludes by suggesting reforms which need to be implemented in order to

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[1] Partner, Majmudar & Partners, Bangalore

[2]Associate, Majmudar & Partners, Bangalore

The authors wish to acknowledge and thank the various interviewees spoken to, for their time and inputs on this topic.

enhance the effectiveness of the current legal regime with respect to corporate governance in India.

INTRODUCTION

The Securities and Exchange Board of India's ("**SEBI**") consultative paper[3] on the review of corporate governance norms in India defines corporate governance as the acceptance by management of a company, of the inalienable rights of the shareholders as the true owners of the corporation and their roles, as trustees on behalf of the shareholders. It has been further defined as the commitment to values, about ethical business conduct and about making the difference between personal and corporate funds in the management of a company. The importance of corporate governance has once again gained prominence in recent times on account of Satyam and Enron fiascos. This article highlights the main issues with respect to implementation of various corporate governance clauses as contained under the Indian legal framework. The important themes being addressed in the article are as follows:

1. Cross - jurisdictional governance compliance - by Indian companies abroad and foreign companies in India;
2. Corporate governance and the private equity sector;
3. Clause 49 of SEBI's Listing Agreement ("**Clause 49**");
4. Whistle-blower's policy in India and its effect on corporate governance;
5. Insider trading law in India and its effect on corporate governance;
6. Forensic audit in India; and
7. Effective enforcement by relevant regulators.

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[3] SEBI, *Consultative Paper on Review of Corporate Governance Norms in India*, http://www.sebi.gov.in/cms/sebi_data/attachdocs/1357290354602.pdf, visited on October 15, 2013.

LEGAL FRAMEWORK OF CORPORATE GOVERNANCE FOR INDIAN COMPANIES

The basic framework for regulation of all companies in India is contained in the Companies Act, 1956, now replaced by the Companies Act, 2013 (in parts) which provides for checks and balances over the powers of the Board of Directors. Under the Securities Contracts (Regulation) Act, 1956, every listed company in India needs to comply with the Listing Agreement stipulated by SEBI. It must be noted that Clause 49 has been the mainstay of corporate governance in India for more than a decade. Although such norms are expected to keep pace with the ever changing corporate scenarios, the previous detailed review of Clause 49 was back in 2004 and the revised norms came into effect in January, 2006. Since then, most of the changes and proposals have been introduced by the Central Government by way of Ministry of Corporate Affairs' Voluntary Guidelines of 2009, and substantial insertions on corporate governance issues in the recently enacted Companies Act, 2013.

KEY CHANGES RELATED TO CORPORATE GOVERNANCE UNDER COMPANIES ACT, 2013

The Companies Act, 2013[4] contains certain new provisions relating to corporate governance and strengthens some of earlier provisions. (The Ministry of Corporate Affairs has notified only 98 Sections of the Companies Act, 2013 as on date).[5] Given below is a summary of corporate governance clauses in the Companies Act, 2013:

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[4] Available at http://www.mca.gov.in/Ministry/pdf/CompaniesAct2013.pdf

[5] Available at http://www.mca.gov.in/Ministry/pdf/CommencementNotificationOfCA2013.pdf.

Fraud Investigation Office: Sections 211 and 212 of the Companies Act, 2013 deal with establishment of Serious Fraud Investigation Office and Investigation into affairs of Company by Serious Fraud Investigation Office respectively, in relation to the frauds relating to a company.

Class action suits: Tracking some of the developed countries, Section 37 and 245 of the Companies Act, 2013 deal with actions by affected persons and class action respectively. Accordingly, a suit may be filed or any other action may be taken by any person, group of persons or any association of persons affected by any misleading statement or the inclusion or omission of any matter in the prospectus.

Enhanced disclosures: With respect to enhanced disclosure requirement, Section 102 of Companies Act, 2013 requires disclosure of not only the names of the interested parties but also the nature and extent of interest of directors, managers, key managerial personnel ("**KPM**") and relatives of directors, manager and KMP in the explanatory statement to be annexed for every special business in the notice calling general meetings.

Independent directors: The Companies Act, 2013 requires all the listed companies to have at least 1/3rd independent directors on their Board. The definition of an Independent Director has been amply broadened and tightened. For example, if a director is a chief executive of an non governmental organization that receives funding from the company to a certain extent, the person would not qualify as an independent director. Also, the new Act has added some positive attributes of independence i.e. the candidate must be "a person of integrity and possess the relevant expertise and experience" in the opinion of the Board. The Companies Act, 2013 further mandates the

formation of 'nomination and remuneration committee'. The concerned committee is required to consider candidates for appointment as independent directors and to recommend to the Board.[6]

The Companies Act, 2013 prescribes new tenure requirements for Independent Directors. The initial term shall be 5 years, following which further appointment of the director would require a special resolution of the shareholders. However, the total tenure of the Independent Director is to not exceed 2 consecutive terms. Further, Independent directors are also personally liable for their actions.

Under the Companies Act, 2013, independent directors are entitled only to fees for attending the meetings of the Board. They are being expressly disallowed from obtaining any stock options in the company. Further, they are also entitled for fees pertaining to reimbursement of expenses for participation in the Board and other meetings and profit related commission as may be approved by the members of the company. The Companies Act, 2013 further contains a code that sets out the role, functions and duties of Independent Directors and incidental provisions relating to their appointment, resignation and evaluation. The code lays down certain broad guidelines like upholding ethical standards of integrity, acting objectively and most importantly devoting sufficient time and attention for informed and balanced decision making. There are certain critical functions entrusted to them – to scrutinise the performance of management and to satisfy themselves on the integrity of financial information and robustness of financial controls and risk management. The

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6 Rishabh A, *Companies Act, 2013: Independent Directors*, http://legaljunction.blogspot.in/2013/09/companies-act-2013-independent-directors.html, visited on October 15, 2013.

role of audit committee has been enhanced thereby placing greater responsibilities on independent directors.[7]

Rotation of auditors: The Ministry of Corporate Affairs has released draft rules to implement the Companies Act, 2013 that, among other things, says that the mandatory rotation of auditors will take place retrospectively, and lists activities that can be defined as corporate social responsibility.

Draft rules: The new draft rules, put up on the website of the corporate affairs ministry, are spread over 16 chapters, including accounting policies, appointment of auditors and directors, the revival of companies, prevention of mismanagement, and the incorporation of companies outside India.The new rules stipulate that company's Board's report on steps taken for energy conservation and their impact, foreign exchange earnings and outgo, and technology absorption, including spending on research and development. The rules further require that every listed company and every other company that has a paid-up share capital of Rs.100 crore or more to appoint at least one woman director on its Board.[8]

CSR: Further, under the Companies Act, 2013 every company having net worth of rupees 500 crore or more, or turnover of rupees 1,000 crore or more or a net profit of rupees five crore or more during any financial year shall constitute a corporate social responsibility committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director which shall ensure that the company spends, in every

[7] *Id.* at 4.
[8] *Companies Act draft rules put a cap on term of auditors*, LIVE MINT AND THE WALL STREET JOURNAL, September 9, 2013.

financial year, at least two per cent of the average net profits which the company made during the three immediately preceding financial years, in pursuance of its corporate social responsibility policy.

CORRELATION BETWEEN CORPORATE GOVERNANCE AND FINANCIAL PERFORMANCE OF COMPANIES

"Did you ever expect a corporation to have a conscience, when it has no soul to be damned, and nobody to be kicked?"

- Edward, First Baron Thurlow

Is there any relationship between investment and governance? Let's talk about China a bit. Despite rapid growth, corporate governance has been very weak in China, with ills such as concentration of state ownership, lack of independence among Boards, insider trading, false financial disclosures, immature capital markets, but still China has more foreign direct investment (**"FDI"**) than India in spite of perceived better corporate governance in India. Why is this the case?

This only leads us to a conclusion that, perhaps, investors flock tocompanies for the returns they provide and corporate governance is only a hygiene factor.[9]The rule of law and formal system of property rights have not been the most essential aspects in explaining FDI inflows within Chinese regions which raises the larger issue as to the difference that a sound domestic legal framework makes in attracting investment. This also implies that a business leader (here the Government of China) who has a long-term career horizon and

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[9]V. R Narasimhan, *Investor Confidence- Imperatives for Good Governance*, Chartered Secretary, Vol XLIII,No.4 April 2013, at 415.

cares about his or her reputation may be able to attract more investment despite not having too many corporate governance systems in place.[10]

To the contrary, for a country that prides itself with robust corporate governance policies, in 2001, the United States of America ("**U.S**") was rocked by the collapse of Enron, a multibillion dollar corporation that employed thousands of people. Only months before Enron's bankruptcy filing in December 2001, the energy trader was widely regarded as one of the most innovative, fastest growing, and best managed businesses in the U. S. With the swift collapse, shareholders, including thousands of Enron workers who held company stock in their retirement accounts, lost tens of billions of dollars.[11] Enron had earlier reported annual revenues which grew from under US$10 billion in the early 1990s to US$ 101 billion in 2000, ranking it seventh on the list of Fortune 500 companies then.[12] The collapse of Enron was largely ascribed to the manipulation of the corporate governance norms by Enron's management.

Let's look at the relationship between share valuation and governance in India - More recently, shares of India's second largest software services exporter Infosys Technologies Private Limited (**"Infosys"**) fell by a margin of 3.9 % on reports that the company is under scrutiny by the United States Department of Homeland Security for likely errors in the employer eligibility documents of its staff working in the U.S.[13]Further, the shares of Sun TV and SpiceJet fell immediately by 31% and 13.5% respectively as the brother of the Chairman of

[10]*Id.* at. *6*
[11]Mark Jickling, *The Enron Collapse: An Overview of Financial Issues*, http://fpc.state.gov/documents/organization/9110.pdf, visited on July 22, 2013.
[12] *Id.* at *6*
[13]*Infosys Falls 4 per cent Amid Fresh Visa Troubles*, THE ECONOMIC TIMES, April 24, 2012.

the two companies was said to be involved in the 2G Spectrum scam.[14] Some of these above examples show some direct relationship between stock prices of a company and the non-compliance of the company or any person who is a part of the company's management to certain laws but not all the time.

Also in India recently, The Children's Investment Fund Management (**"TCI"**) has accused Coal India Limited (**"CIL"**) of improper and unprofitable practices. TCI, a minority stakeholder of Coal India had, on March 5, 2013 sent a letter to the CIL's directors alleging that the incumbent Chairman of CIL was incompetent in protecting CIL's net income from erosion by rising diesel and wage costs and general inflationary pressures.[15] This incident once again threw light on a legal system which has not been able to assure adequate levels of corporate governance in India. However, in a country like India, corruption has been considered to be a socio-political malaise with every sector of Indian society being affected by it[16]

Scholars such as Milton Friedman opine that there is one and only one social responsibility of business, which is to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud[17] It is largely considered that unlike political governance, corporate governance is primarily contractual in nature, and that corporate governance is

[14]*Sun TV, SpiceJet share prices fall due to DayanidhiMaran 2G scam*, http://www.metromasti.com/top/news/Sun-TV,SpiceJet-Share-prices-fall-due-to-Dayanidhi-Maran-2G-scam/9233, visited on July 12, 2013

[15]*Coal India plans lawsuit against TCI*, INDIAN EXPRESS, April 11, 2013

[16]Abhay Vaidya, *Nine years of UPA: What makes Sonia Gandhi the Real Hero*, FIRSTPOST, **May 23, 2013.**

[17]Milton Friedman, *The Social Responsibility of Business is to Increase its Profits*, THE NEW YORK TIMES MAGAZINE, September 13, 1970.

at the bottom of enforcing the spirit of this contractual relationship.[18]Studies have shown that in advanced nations like U.S, not many companies are concerned about values and instead focus exclusively on maximizing profits.[19]The argument here isn't that managers and Boards always know best. It's simply that widely dispersed short-term shareholders are unlikely to know better and that a governance system that relies on them to keep corporations on the straight and narrow is doomed to fail.[20]

So, does it mean that the investors in India care about corporate governance at all? Several studies in India and abroad have indicated that markets and investors take notice of well managed companies and respond positively to them.[21] Better governed firms have been observed to carry higher stock prices and vice versa**.** This has been attributed to the fact that better managed firms will perform better and as a result stock prices will increase.[22]

It is important to note that the components which are usually considered while assessing the status of corporate governance in a company are Board independence, chief executive officer (**"CEO"**) duality, existence of remuneration and nomination committees and the existence and expertise of audit committee. For example these structures can be seen in well-managed

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[18]Jayanth Rama Varma, *Disciplining the Dominant Shareholder*, http://www.iimahd.ernet.in/~jrvarma/papers/iimbr9-4.pdf, visited on July 15, 2013.

[19] Hershey H. Friedman and Linda Weiser Friedman, *How Virtuous is Your Firm? A Checklist*, Electronic Journal of Business Ethics and Organization Studies, Vol. 14, No. 1 (2009), at 14.

[20]*Justin Fox and Jay W. Lorsch,* What Good Are Shareholders?*, http://hbr.org/2012/07/what-good-are-shareholders/, visited on July 23, 2013.*

[21]*Corporate Governance: Benefits and Limitations*, http://business.gov.in/corporate_governance/benefits_limitations.php, visited on July 8, 2013.

[22]Saif Ullah Malik, *Relationship between Corporate Governance Score and Stock Prices: Evidence from KSE-30 Index Companies*, http://www.ijbssnet.com/journals/Vol_3_No_4_Special_Issue_February_2012/28.pdf, visited on July 18, 2013.

companies such as HDFC, Infosys, ITC Limited, etc.[23]These companies enjoy a tremendous amount of market good will which carries them through tough times and when there is any dilution in corporate governance standards in these well managed companies, the public is immediately aware of these and it impacts share valuations. It has been found that better-governed corporate frameworks benefit companies through greater access to financing, lower cost of capital, better firm performance, and more favorable treatment meted out to of all the stakeholders of a company.[24] In India, studies show that SEBI's regulation on corporate governance has been effective in providing more and timely information to the investors, who in turn could use the information to determine appropriate risks of the stocks and thereby maximizing the shareholders wealth.[25]

We can therefore definitely conclude that in India, better corporate governance standards adopted by companies can lead to increased access to external financing by either private equity players or bankers which in turn leads to larger investments, higher growth, and greater employment creation, and finally increased valuations. Also, good corporate governance can mean generally better relationships with all stakeholders, which helps improve social

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[23]Annual reports of these companies as available at http://www.hdfcbank.com/htdocs/common/pdf/corporate/HDB_Annual_Report_2013.pdf, http://www.infosys.com/investors/reports-filings/annual-report/annual/Documents/Infosys-AR-13.pdf and http://www.itc.com.hk/pdf/annual_reports/20130708135928_1.pdf respectively, visited on July 30, 2013.

[24]StijnClaessens and BurcinYurtoglu, *Corporate Governance and Development—An Update*, *at* http://www.gcgf.org/wps/wcm/connect/518e9e804a70d9ed942ad6e6e3180238/focus10_cg%26development.pdf?mod=ajperes, visited on June 30, 2013

[25]Asish K Bhattacharyya, AjitavaRaychauduri and SadhalaxmiVivekRao, *Economic Consequences of 'Regulation on Corporate Governance': Evidence from India,* http://ssrn.com/abstract=640842, visited on July 14, 2013.

and labour relationships.[26] It is hard for investors to have confidence in a company with a weak corporate governance mechanism or in a regulatory framework which has been found to be repeatedly ineffective. Corporate governance is incredibly important as it manifests itself in the long-term performance of companies. It therefore must be noted that well-run companies tend to have support of shareholders, suffer less volatility at times of maximum stress[27], with less severe share price falls[28]and that corporate governance goes hand in hand with the long term financial performance of a company and is directly affected by the strength of the legal framework which is applicable to that body corporate.

CROSS-JURISDICTIONAL COMPLIANCE

As the world is now globalised, in this section we look at cross- border issues. Recently, Japanese drug maker Daiichi Sankyo Co, which bought control of India headquartered Ranbaxy Laboratoriesin 2008, said that it believed that certain unnamed former shareholders of the company had hidden information regarding regulatory probes by U.S into Ranbaxy. Additionally, Ranbaxy pleaded guilty to felony charges related to drug safety and agreed to pay US$500 million in civil and criminal fines under a settlement with the United States Department of Justice.[29] Further, a European regulator is to fine Ranbaxy and seven other

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[26] *Id.* at. 9

[27] For e.g. shares of ICICI Bank, Axis Bank and HDFC Bank were largely unmoved by the Cobrapost.com expose charging these banks with abetting money laundering as the corporate governance standards in these organizations is normally very robust and sound.

[28]Jan Hall, Thomas O' Malley, *Corporate Governance and the Effectiveness Of Shareholder Engagement*, http://www.jcagroup.net/perch/resources/publications/corporate-governance-shareholder-engagement.pdf, visited on July 12, 2013

[29]*Daiichi Sankyo Says It Was Misled Over Ranbaxy Probes*, http://in.reuters.com/article/2013/05/22/ranbaxy-daiichi-usa-fine-idINDEE94L0C820130522, visited on July 7, 2013.

makers of generic drugs for limiting the supply of cheaper medicines.[30]This shows that outbound Indian business entities are increasingly at the risk of ensuring corporate governance compliance in the various jurisdictions they operate and in the absence of the same, potential risks and liabilities may arise.

It is now widely accepted that the corporate governance system varies across jurisdictions. Ownership and Board structures, managerial incentives, the role of banks and large financial institutions, the size and development of stock markets, company law, securities regulation, government involvement and other important aspects of corporate governance have been found to differ across nations. Today, business of companies is not confined to one country only. They have crossed the borders of India and have presence in many countries.[31]What works in one country does not work in the other and accordingly what works in India may not be applicable elsewhere. There are always cultural differences between the legal regimes adopted in any two nations. In India, for example norms are less severe for acquiring unlisted companies but it may not be the same in other countries.[32]So increasingly Indian companies need to factor in all these compliance and governance issues while planning to do business outside India.

We have focused on one sector – namely information technology companies who have strong businesses outside India. There are various governance related laws to be adhered to by the information technology

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[30] *EU To Fine Ranbaxy, Others For Blocking Generic Drugs,* BUSINESS STANDARD, June 3, 2013.
[31]Syeedun Nisa and Khurshid Anwar Warsi, *The Divergent Corporate Governance Standards and the Need for Universally Acceptable Governance Practices*, www.ccsenet.org/journal/index.php/ass/article/download/1087/1046, visited on July 7, 2013.
[32]V. Umakanth, Faculty of Law, National University of Singapore .

companies which are based in India but have substantial operations abroad. It has been observed that Indian software and other companies listed overseas, especially in the U.S, followed the principles of voluntarily imbibing greater measures of corporate governance for the perceived value it created for their businesses.[33]For example, Infosys is compliant with Section 404 of the Sarbanes Oxley Act of 2002 (**"SOX Act"**).[34] All companies, including Indian companies, which are listed on U.S stock exchanges, are required to comply with the requirements of the SOX Act. The other way round, all foreign companies listed on stock exchanges in India have to comply with SEBI's Listing Agreement.[35]Cross jurisdictional compliance has been a major driving factor which ensures that Indian companies which have been listed in a stock market under a foreign jurisdiction also comply with local Indian laws. However, though there are always more strings attached with compliance in multiple jurisdictions by corporations, the governance system being complied with by well managed companies is typically the more stringent of the two.[36]

With respect to compliance by foreign companies functioning in India, it is important to note that recently an internal corruption probe lead Walmart to suspend associates in India and Reebok to write off losses due to corporate fraud in India. Does this mean that multinational corporations (**"MNC"**) in a rush to open stores and grab business end up lowering their corporate

[33]Kshama V Kaushik and Rewa P Khamboj, *Study On The State Of Corporate Governance In India*, \ http://www.iica.in/images/SEBI.pdf, visited on July 3, 2013.
[34]*Infosys is compliant with SOX Act,* THE ECONOMIC TIMES, October 25, 2005.
[35] A. Choksi*, SOX Compliance — An Introduction And Business Process Documentation — Tools and Techniques,* \ http://www.bcasonline.org/articles/artin.asp?611, visited on July 30, 2013.
[36]*Supra* note 32 at 11

governance standards in emerging markets like India or do countries such as India and China perplex them with their unique challenges?[37]

It has been found that more often than not, that India is the only country outside the home market where some foreign brands have a listed entity. So the Board and senior management are seldom quite unaware as to how to deal with this. The focus is always on compliance with regulations in the home market, with the compliance in Indian subsidiaries being sidelined. The senior management in such Indian companies are invariably brought in or appointed by the foreign based parent companies and their future career paths in the group and incentives are controlled by the parent companies and as a result focusing on transfer of profits to the parent company has become a priority to the Indian management of such foreign based companies functional in India. It has further been found that there have been instances where the parent MNCs have informed local CEOs clearly that they do not have to bother about local investors but should focus on their foreign shareholders. The conflict of global profit is at the cost of local profit and is very much tilted in the favour of the parent company. The Indian listed subsidiaries, or associates of MNCs, rarely show concern for local investors and often compromise on standards.[38] Additionally in India, there have been instances where MNCs have merged or restructured assets between their wholly owned subsidiaries and the Indian listed company and such restructurings of businesses have been done at valuations that are clearly unfavourable to minority shareholders.[39] Both analysts and shareholder advisory firms are unanimous in their view that MNCs on paper

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[37] *Corporate governance of MNCs in India: Is the slip showing?*, BUSINESS STANDARD, December 13, 2012.

[38] Anil Singhvi, *MNCs Operating Out Of Emerging Markets Dilute Their Governance Standards*, BUSINESS STANDARD, December 13, 2012.

[39] *Id.* at 12

have better corporate governance standards at the parent level as compared to most of their Indian peers.[40] This brings us to the conclusion that many foreign based companies which are functional in India are being let off without strict actions being taken against their non-compliance with the domestic laws.

CORPORATE GOVERNANCE AND THE PRIVATE EQUITY SECTOR:

The Indian economy has been showing a gradual and consistent shift from the manufacturing sector to the service sector. Private equity as an industry has become a prominent mode to finance companies involved in the service sector. The past century saw some of the current information technology giants turning to this sector for mobilizing the initial capital. In India, currently the sudden spurt of domestic e-commerce sites can be attributed to the private equity investors. Companies belonging to the service sector are relying largely on private equity players to mobilize funds as opposed to opting for loans from banks and funds raised from initial public offering, which are preferred mainly by companies in the manufacturing sector such as those companies which are involved in the housing and construction industry. Hence in case of startups for which traditional means of financing are not available, funds made available by private equity players is a boon. It is important to distinguish between good governance and bad governance in companies with respect to the private equity industry, mainly because the presence or absence of good governance can act as a deterrent or a catalyst towards attracting investment by companies eyeing private equity firms to raise capital.

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[40] Sudipto Dey, *Double standards or greed?*, BUSINESS STANDARD, May 29, 2013.

Industry experts[41] we spoke to have given us very useful insights with respect to how corporate governance norms can be made applicable in the private equity industry with respect to prospective investee companies. Based on discussions it has been found that private equity investors give importance to compliance with corporate governance norms in startups so that such startups can attractsubstantial investment in the future. In practice, private equity investors do distinguish between the corporate governance standards insisted by them in startups as against companies which are sufficiently well established. In startups which have just begun functioning, corporate governance levels are minimal. In practice, as soon as a Nominee Director is appointed by the private equity firm on the Board of startups, corporate governance is assured to be given importance. Compliance with corporate governance provisions which are binding on a company are taken care of by incorporating the same into the shareholders agreement. The private equity investors keep a tight grip on corporate governance in such companies aiming at greater transparency by listing reserved matters in the shareholders agreement, which are always decided in consultation with the private equity investors and also by them having a say on what would constitute a quorum for the purpose of a Board meeting of the investee company post investment. All these aspects (nominee director, quorum requirements) are subsequently incorporated into the articles of association of the investee company. Also in practice, private equity investors insist that labour laws and any compliance as required under Companies Act, 1956 is complied with by the investee company prior to such investment. It is interesting to note that private equity investors generally insist on minimal secretarial compliance in investee companies which are startups, instead of strict legal compliance which

[41] *Supra* note 32 at 11 and Vinod Kumar Menon, General Counsel, Accel Partners, Bangalore.

is insisted upon usually in established companies.Also private equity investors usually appoint chartered accountants in bigger companies and insist that a compliance certificate has to be compulsorily provided by the chief financial officer of such an investee company. Additionally the private equity investors generally shield themselves of any future liability by appointing the CEO as the *'officer in default'*who shall be made liable in the instance of any non-compliance by the company, while the investor director nominated by the Board is shielded from any kind of liability.[42]

It has been observed that the finance sector has started to lay huge emphasis on corporate governance especially over the past 5 (five) years, legal due diligence as a mode of ensuring corporate governance has become extremely significant. One of the private equity investors we interacted with, also mentioned that their firm had officially backed out of an investment in 3 (three) companies after it was found that there were many violations on part of these companies in terms of compliance with certain stamp duty requirements, despite having commercially agreed to investing in the company. In another instance, the private equity investor did not go ahead with investment in a company which dealt with providing security services and with a 40,000 (forty thousand) employee count, as it had not maintained a gratuity fund since the past 5 (five) years, and that such non-compliance would directly affect the long term prospects of the company if an employee made a gratuity claim at a later point.[43] Further, it has been established that private-equity funded companies display higher standards of corporate governance than firms that do not receive such funding. This difference primarily arises from the application of advanced

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[42] *Supra* note 41 at 13, Menon
[43] *Id.* at 14

country standards of corporate governance arising from the investors of developed countries that own such private equity funds. Studies have shown that the most common strategies used in practice by private equity firms for achieving this is by the reconstitution of the Board of the investee company, influencing senior executive recruitment and changing the firm's operating and strategic rules.[44]

As reported by an industry expert, the violations which are usually given prominence by the private equity investors in prospective investee companies are usually analyzed from a business perspective (investors are usually concerned about everything which affects the business value of a company) and the most common violation is that of affiliated transactions not being disclosed (however such non-compliance by the investor has been found to have no forbearance on the valuation of the company), and that usually the domain names and logos are in the name of the founder of the company instead of in the name of the company itself. Also, stamp duty violations are commonly seen in prospective investee companies.[45]However, information made available by a company to an existing shareholder/ prospective investor in the public domain also speaks volumes about the levels of governance in a company. The current trend among many of the well managed corporate entities[46] in India is that their annual reports disclosed to the public cover relevant information with respect to topics such as governance structure, role taken up by various committees,

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[44]*Rafiq Dossani,* Private equity and corporate governance in India*, http://www.emeraldinsight.com/journals.htm?articleid=17046850, visted on July 20, 2013.*

[45]*Supra* note 41 at 13, Menon

[46]Such as Infosys and Indian Tobbaco Corporation, See http://www.infosys.com/investors/reports-filings/annual-report/annual/Documents/AR-2012/Annual_Report.html and http://www.itc.com.hk/pdf/annual_reports/20130708135928_1.pdf, visited on July 24, 2013.

management personnel; information placed before the Board, post board meeting follow-up system, compliance to any non-mandatory recommendations under Clause 49; etc. It is interesting to note that in many annual reports the chapter exclusively relating to corporate governance runs into a large number of pages.[47]

As noted by one of the industry experts we spoke to[48], a decade back parties investing in private equity funds totally relied upon the management of these entities to make the decision on their behalf as the trust factor ruled very high. Now, it is largely believed that the trust factor goes hand in hand with the requirement of legal compliance being satisfied by a prospective investee company. Also in general, in the private equity market there was a general perception among the investors that conducting legal due diligence prior to investment in a company was leading to a situation where lawyers were being paid huge fee unnecessarily. To the contrary, off late, both the promoter and the investor in the private equity firms are on the same level of emphasis for corporate governance in a prospective investee company. The thrust in the private equity industry has been seen to be shifting swiftly from conducting only financial due diligence to extending the scope to include compulsory legal due diligence.

Towards, this end, at the global level, mergers and acquisitions, transactions are seeing a great deal more attention being paid to pre-acquisition anti-bribery due diligence.[49]The Bribery Act of United Kingdom, and its U.S. counterpart, the Foreign Corrupt Practices Act ("**FCPA**") are the key

[47]*Supra* note 23 at 8

[48] *Supra* note 41 at 13, Menon

[49] Bill Waite, *What's changed under the UK Bribery Act? Due Diligence In Mergers And Acquisitions* , http://www.fcpablog.com/blog/2013/8/15/whats-changed-under-the-uk-bribery-act-due-diligence-in-merg.html#sthash.8CDIhZFc.dpuf, visted on October 14, 2013.

pieces of legislation tackling bribery and corruption on a domestic and international basis. Committing an offence under either act can lead to corporate and individual liability, both criminal and civil. For corporate entities, the fines imposed for corrupt conduct can be significant, and the reputational damage and business disruption that comes from being embroiled in an investigation can have long-lasting effects. In the U.S., it is well established that an acquiring entity may find itself liable for the historic corrupt conduct of an entity that it has acquired. This inheritance of successor liability has been central in making sure that the FCPA compliance due diligence is a standard, and important, part of any merger and acqusition transaction. As such, the advisable approach for any entity making an acquisition, particularly when the target operates in a high risk industry or location, would be to follow the approach advocated by the U.S. enforcement bodies. Where possible, anti-bribery due diligence should be carried out in the early stages of the transaction. But, in circumstances where that is not feasible pre-closing, once the transaction is completed the acquirer should carry the responsibility and instigate proper reviews, implement suitable policies and procedures and, where necessary take remedial steps to address any existing problems.[50]

However, most of the global investors still continue to discuss only the financials with the private equity investors and trust the private equity investors completely on the non-financial aspects.[51]

As the audit committee in any company directly controls the kind of information being divulged to the shareholders, one of the experts we spoke to,

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[50] Lisa Navarro, *A view from London: Anti-Bribery Due Diligence In M&A Transactions,* http://www.lexology.com/library/detail.aspx?g=fb1c43e0-f66f-4888-a0d4-5bbb5fc8c1af, visted on October 14, 2013.

[51] *Supra* note 41 at 13, Menon

highlighted the need for strengthening the Committee and noted that further the governance structure in a prospective investee company depends on whether the same is listed or whether it is unlisted. In light of this, the expert noted that the aim of private equity investors would be to set ready an unlisted investee company for an initial public offering at a later point.[52] A major step forward in this direction has been the issuance of Securities and Exchange Board of India (Listing of Specified Securities on Institutional Trading Platform) Regulations, 2013[53].The regulation enables small and medium enterprises ("**SME*s***") to list on the stock exchanges without going through an initial public offering ("**IPO**"). Under the Regulations, a separate institutional trading platform is available in an SME exchange for listing and trading of specified securities of SMEs for informed investors. Such listing may be availed of without going through a public offering process. Although there is no IPO requirement under the regulation, the process of listing necessitates appropriate disclosures. Hence, the company is required to prepare an information document containing prescribed disclosures, which must be hosted on the website of the recognised stock exchange. These disclosures appear far less onerous compared to those in an IPO. Also, the information document is not required to be filed in draft form before SEBI for its comments. Hence, the listing is largely a private process with limited regulatory involvement, except on the part of the stock exchange.[54]

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[52]*Supra* note 32 at 11

[53] Available at http://www.sebi.gov.in/cms/sebi_data/attachdocs/1381311146097.pdf.

[54] Umakanth Varottil, *Institutional Trading Platform for SMEs*, http://indiacorplaw.blogspot.in/2013/10/institutional-trading-platform-for-smes.html, last visted on October 12, 2013.

It has been further identified by the expert that an immediate requirement to be fulfilled in order to achieve an investor friendly environment for regulation of unlisted companies with regards to corporate governance is the compliance to a regulation which is not as stringent as Clause 49, but instead a self- developed system which ensures a minimum level of compliance (The industry expert further noted that maximum efficiency can be reached if it is ensured that the reporting system to the board is adequate) which would be inclusive of complying with minimum requirements such as giving compliance report to the Board every quarter, any relevant reporting compliance to be made to the Reserve Bank of India under the relevant extant guidelines issued by it.[55]

Experts[56] have further identified that the major burning issue with respect to the Indian legal regime which needs immediate attention is the enforceability of commercial contracts. It has been noted that in countries such as the U.S, enforceability of a commercial contract which has been breached is not a complex issue, while in India the enforceability of a contract by approaching the courts is a less effective mechanism. This disadvantage has been reported to be acting as a major deterrent factor for global investors for investing in India and as a result it is seen that most of the investors are choosing Singapore as the venue for arbitrationas opposed to pursuing civil litigation for enforcement of contract in India. The failure of the Indian legal system to address investor grievances in a speedy manner has been reported to be affecting the bargaining powers available to the Indian private equity firms

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[55] *Supra* note 41 at 13 , Menon

[56] *Id.*. *at* 18 and Sanjay Rego,Former Senior Manager at Deloitte.

with the global investors, as companies are increasingly looking at enforcing contracts outside India.[57]

One expert we spoke to has observed that in order to ensure compliance to corporate governance norms by a private equity investor in a prospective investee company,rational investor directors need to be appointed by the private equity investors on to the Board of an investee company. He further noted that such directors need to pose the right questions (pertaining to the effective management of the affairs of the company) to the management of the company and that even having a handful number of such directors on the board who pose the right questions can make a huge difference to corporate governance levels in the company.This requirement can be easily fulfilled followed by startups.[58]

In countries like the U.S, private equity firms have played a huge role in the corporate governance of companies as they are able to contractually impose conditions on the investee companies. Private equity investors can educate investee companies about the benefits of corporate governance without increasing costs. The level of corporate governance insisted by an investor is based on the sector to which the investor belongs and as to whether he is profit driven or governance driven. Hence, one solution does not fit all investors. But, it is always good to not replace the management as a measure to ensure adequate levels of governance in a company.[59] It is important to note that, under thecurrent Indian legal regime, there is nothing under the relevant corruption laws which specifically regulate corruption by private entities, while at the same time, Indian corporates have been found to possess a lackadaisical attitude with

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[57]S*upra* note 41 at 13, Menon
[58]S*upra* note 32 at 11
[59]*Supra* note 56 at 18, Rego

respect to violations they are a party to under foreign corruption laws. Also, in India there is a shortage of independent directors in the private equity space, especially,the ones who are financially literate.[60] Hence, both these issues need to be immediately addressed if the private equity industry is to expand to its full capacity in India.

IS THE CURRENT CLAUSE 49 DYNAMIC WITH WORLD MARKET REQUIREMENTS?

When Clause 49 was introduced, it was considered as the Indian version of SOX Act and as a very important piece of legislation introducing good governance practices.The current Clause 49 requires the CEO and Chief Financial Officer to accept responsibility for establishing and maintaining internal controls and to evaluate the effectiveness of the company's internal control systems. Clause 49, however, does not specify the underlying documentation requirements; neither does it recommend an internal control framework against which to benchmark the internal control system. Clause 49 addresses other Board related issues such as number and timing of Board meetings, but at the same time it does not address board dynamics, the role and responsibilities of the chairman, the selection process for non-executive directors, director training, and Board procedure, amongst others.[61]On the other hand to effectively address the same Board related issues, the SOX Act requires disclosures regarding off balance- sheet transactions and pro forma figures and mandates accelerated reporting of trading by directors, officers, and principal stockholders. Hence, similar parameters should be expressly incorporated into Clause 49 for ensuring greater transparency in the affairs of a company.

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[60] *Id. at* 19

[61]*Supra* note 35 at 11

One of the main concerns regarding Clause 49 has been as to whether it can be completely effective given that the structure of many Indian businesses, where board members may be reluctant to question leaders of family run businesses. For example, many argue that it is highly unlikely that a board would ever oust promoters (whose families have been running the companies over many generations). Many experts believe that despite India's formal governance standards, the fundamental reality of Indian business is that most are still controlled by family shareholders or are government-controlled and hence undermines the effectiveness of these standards. Therefore Clause 49 always needs to be assessed by SEBI for the purpose of any future amendments by keeping the above *'family driven promoter'* structure in mind.

In January 2013, SEBI issued a consultative paper proposing tougher guidelines for listed companies.[62] SEBI's proposals sought to bring Clause 49 into line with the recently enacted Companies Act, 2013, and to impose more stringent regime for listed companies.[63] The consultative paper suggests that independent directors be appointed by minority shareholders and that such directors should be formally trained to be on a company's Board and regularly evaluated for their performance. Further, to avoid concentration of power in one person's hands, the regulator has proposed separating the position of chairman from that of managing director of a company. The paper also suggests measures such as rationalizing CEO pay packets, improving compliance for the benefit of small investors, making whistle-blower mechanisms compulsory, and implementing orderly succession planning. Furthermore, to strengthen the monitoring of compliance, SEBI has suggested that credit rating agencies carry

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[62]*SEBI moots tougher norms for corporate governance,* THE HINDU, January 7, 2013.

[63] Ranjana Roy Gawai &VasudhaSen, *Corporate Governance Undergoing Major Review*, India Business Law Journal, March 2013, Volume 6, Issue 8, at 49.

out corporate governance rating, and that stock exchanges/SEBI conduct inspections to verify compliance. These proposals, if implemented, would surely bring Indian corporate governance norms up to the highest global standards and make Indian companies more transparent and accountable.[64]

Recently it was announced that SEBI was focusing on how to make compliance to corporate governance rules more cost-efficient for companies so that they consider it an investment rather than expenditure; and that it would add value both in terms of image and profitability.[65]The Ministry of Corporate Affairs had earlier opined that best practice standards have to be imposed on everyone appropriately and that a debate on whether to put up a uniform corporate governance code for all companies will require the consideration of compliance cost[66] that is required for meeting such SEBI norms. However, such compliance cost has to be kept in mind, looking at different levels and sizes of companies.[67]Hence, a step ahead in this direction will also be commendable in ensuring effective regulation of private companies operating in India.

In light of the above, it is important to note that the President of India promulgated the Securities Laws (Amendment) Ordinance, 2013[68] and as a result, in what has been a long wait for the officials of SEBI, sweeping powers have been given to SEBI to book any person or enterprise who, during the course of investigation, has omitted to provide information, would not provide information or would destroy, mutilate information or documents by allowing it to also search and sieze documents of. Primarily, the Ordinance gives power to

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[64]*Id.* at 20

[65]*Delivering Value Through Corporate Governance*, http://www.domain-b.com/economy/governance/20050822_corporate.html, visted on July 12, 2013.

[66]*Best Practice Norms May Be Extended To Unlisted Cos*, TIMES OF INDIA, April 22, 2010.

[67] *Id.* at. 21

[68] Available at http://www.sebi.gov.in/cms/sebi_data/attachdocs/1379571262546.pdf.

SEBI to call for any information or records from any person including bank or any other authority or board or corporation, which shall be required in respect of any investigation or inquiry by SEBI. In addition to this, a deeming provision has been added whereby any pooling of funds under any scheme of arrangement involving a corpus of Rs. 100 crore or more and not registered with SEBI, shall also be taken to be a Collective Investment Scheme. Further, the Ordinance provides for constitution of special courts for speedy trial of offences.[69] By giving retrospective effect to ask for information on old cases from foreign regulators, SEBI has been given more teeth in relation to cases pending for more than 15 years.[70]

WHISTLE-BLOWER'S POLICY IN INDIA

One of the key policies in Clause 49 was the whistle-blower policy which was aimed to encourage employees and others, including former employees, or members of an organization, especially a business or government agency, who reports unethical or improper practice (not necessarily a violation of law) to approach the independent audit committee without necessarily informing the board.[71] Clause 49 states that every company should disclose in the corporate governance section of its annual report whether a whistle -blower policy is in effect or not, and whether all the employees are granted access to it or not. This disclosure in the annual report is mandatory, but framing a whistle blower policy itself is non-mandatory in India.In India, typically, a whistle-blower is governed

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[69] Nivedita Shankar, *Securities Laws (Amendment) Ordinance, 2013 gives more teeth to SEBI* , http://indiacorplaw.blogspot.in/2013/07/securities-laws-amendment-ordinance_27.html, visited on October 12, 2013.

[70] *Id.* at 22

[71] *Report of the SEBI Committee on Corporate Governance* dated February 8, 2003, available at www.sebi.gov.in/commreport/corpgov.pdf.

by an internal company policy which in non-mandatory and wherein cases of wrong doing of any kind can be brought to the notice of the top management.[72]

An increasingly positive trend is emerging in India wherein, companies such as India Infrastructure Finance Company Limited[73], Maruti Suzuki India Limited[74] and Saint Gobain[75] have drafted and made applicable exclusive whistle-blower's policy to their respective organizations.An important aspect of the whistle-blower's policy under Clause 49 is that the identity of the informer should be kept secret and they must be safeguarded from the unfair termination and other unfair or prejudicial employment practices. But it is important to note that an even more clear policy and procedure for raising issues will help to reduce the risk of serious concerns such as the whistle-blower being mishandled by any insider or by the organization.[76] Dinesh Thakur, the former Ranbaxy director, took home US$48.6 million after uncovering the unsafe practices and violations at Ranbaxy in U.S.[77] Legal experts say it is surprising that the official's name in Ranbaxy was made public since the Witness Protection Programme in the U.S ensures complete secrecy and protection to the whistle-blower. Many times, people are taking a big risk and such cases pose a threat to life and liberty. Even in the US, whistle-blowers tend to get impacted adversely.[78]Hence

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[72]Kala Vijayaraghavan and Satish John, *Framing of Whistle-Blower Policy is Not Yet Mandatory for India Inc*, ECONOMIC TIMES, May 15 2013.

[73]Available at http://www.iifcl.org/Content/WhistlePolicy.aspx, visited on July 28, 2013

[74] Available at http://www.marutisuzuki.com/whistle-blower-policy.aspx, visited on July 26, 2013

[75] Available at http://www.saint-gobain.co.in/_whistle_blower_policy.html, visted on July 28, 2013

[76] *Whistleblowing: Making a Disclosure in the Public Interest,* http://www.human-resource-solutions.co.uk/HR-Policy-Pages/Whistleblowing/Whistleblowing.htm, visted on July 22, 2013

[77] *SPK Group, US fines Indian drug giant Ranbaxy US$500m,* http://spkgroups.com/news~asia-pacific~4455~us-fines-indian-drug-giant-ranbaxy-usdollar500m.html, Visited on October 15, 2013

[78]*Supra* note 72 at 22

retaining the anonymity of the whistle-blower is a very significant for realizing the purpose of whistle-blower's policy.

It has been found that the success of whistle-blowing to a large extent depends on an organization's culture. If the leadership is authoritative there is fear and the culture is closed to whistle-blowers. The top management of companies has to encourage whistle-blowers and an independent body needs to examine the case and offer enough support to the whistle-blowers. So the implementation of this policy is gaining traction very selectively and will progress as our overall governance picks up. The lack of proactive regulators and great rewards could be another reason for this policy not to have taken off in a big way in India. Also with respect to enforcement against corporates by the regulator, the fines levied by Indian regulators are minuscule in comparison to the actual offence. Even when regulators have imposed fines, many of their decisions are challenged in courts, leading to protracted decisions.[79]This is an additional reason which is acting as a deterrent to the effective functioning of whistle-blower's policy in India.

Hence in India, we need a policy which ensures strict anonymity to whistle-blowers and that which allows whistle-blowers to alert government regulatory authorities in the instance of any misfeasance or malfeasance of regulatory norms by a company and it is wiser to incorporate such a whistle-blower policy under the Companies Act, 2013 so as to encompass even private companies under its ambit and to encourage employees to divulge information which may help in the early detection of a prospective corporate scam.

INSIDER TRADING RELATED LAW IN INDIA

[79]*Supra* note 72 at 23

The Galleon Group, one of the world's largest hedge funds, collapsed following its involvement in an insider trading scandal four years ago and resulted in the conviction of Rajaratnam, and his accomplice Gupta, the trend-setting former head of the management consultancy McKinsey.[80]Rajat Gupta, along with two others was charged for tipping Galleon group's Rajaratnam with insider information worth billions in the biggest hedge fund cases in the US history[81]and Rajaratnam and RajatGupta were convicted for their participation in insider trading in 2012.[82] This case emphasized upon the unforgiving nature of securities fraud accusations as the Rajaratnam conviction seemingly reverberated through the courts, leading to strict interpretations of procedural rules attending unrelated insider trading cases.[83]

Throwing light on the corresponding legal framework in India, the SEBI (Prohibition of Insider Trading) Regulations, 1992, requires that a person who is connected with a listed company and is in possession of any unpublished price sensitive information likely to materially affect the price of securities of company, shall not on his behalf or on behalf of any other person, deal in securities or communicate such information to any other person, who while in possession of such information shall not deal in securities. Accordingly, there are certain periodic and continuous disclosures to be made by shareholders of

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[80]*Rajat Gupta's Conviction Does Not Mean the End Of the Indian Story in America*, http://www.rediff.com/business/slide-show/slide-show-1-special-rajat-guptas-conviction-not-the-end-of-indian-story-in-us/20130628.htm, visted on July 17, 2013.

[81] Job Anbalagan, *Insider Trading - A Menace To Corporate Governance*, http://blogs.siliconindia.com/ethicsmanagement/Business/Insider-trading--a-menace-to-Corporate-Governance-bid-G7HiZeQM66642633.html, visted on July 17, 2013.

[82]Rajaratnam was found guilty on all 14 charges and sentenced to 11 years in prison for profiting from tips he received from Robert Moffat, Anil Kumar, Rajiv Goel, and Roomy Khan; Lattman, Peter; Ahmed, Azam*"Galleon's Rajaratnam Found Guilty"*, NEW YORK TIMES, May 11, 2011.

[83]Scott Colesanti**,** *Wall Street as Yossarian: The Other Effects of the Rajaratnam InsiderTrading Conviction,* http://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=1196766, visted on July 18, 2013.

public listed companies to enable SEBI to enable to track any pattern of insider trading. These regulations were amended in 2002. The amendment requires all the listed companies, market intermediaries and advisers to follow the new regulations and also to take steps in advance to prevent the practice of insider trading. The regulations include disclosures, by the directors and other officer, of listed companies and also by persons holding more than 5% of the company's shares. Insider trading practice is also required to be curbed during vital announcements of the company. These preventive measures ensure the reduction of the cases involving the practice of insider trading.[84]

Recently, in India,in an action taken against one of the high profile insider trading cases, SEBI fined Reliance Industries group entity Reliance Petroinvestments (**"RPIL"**) Rs. 11 crore for violating[85] insider trading norms in the shares of erstwhile Indian Petrochemicals Corporation Limited (**"IPCL"**) before its merger with Reliance Industries Limited (**"RIL"**).[86]But India does not have imprisonment related provisions in the instance of non-compliance with the SEBI (Insider Trading) Regulations, 1992. The insider trading related regime in India can be said to be soft, wherein the Securities Appellate Tribunal has in the past also held that if a person who had indulged in insider trading had no

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[84]Aakriti Raizada and Jinal Chedda, *Point Blank*, Legal Era, July 2012, Vol.III, Issue V, at 34

[85] Please note that theshare price of IPCL on March 5, 2007, declined by 8.13 per cent on the Bombay Stock Exchange when the Sensex declined by 3.79 per cent. However, in a divergence from the index, the scrip witnessed substantial price gain on the following days, subsequent to the announcement of amalgamation of IPCL, of which RPIL was the promoter having control over the company and holding 46 per cent shares with Reliance Industries. The findings of the investigation led to the allegation that RPIL was in the possession of unpublished price sensitive information while trading in the scrip of IPCL prior to announcement of declaration of interim dividend and amalgamation of IPCL with Reliance Industries which resulted in violation of regulation 3 of SEBI (Prohibition of Insider Trading) Regulations, 1992.

[86]*Insider Trading Case: Sebi Slaps Rs 11 Crore Fine On RIL Firm*, INDIAN EXPRESS, May 3, 2013.

intention of gaining any unfair advantage, then the charge of insider trading cannot be sustained.[87]

There is a need to amend the legal framework concerning insider trading in India, which would compel an insider to disgorge or turn in profits made by insiders to the company for any transaction in equity based securities in the company's securities (including its parents or subsidiary's shares) if both the buy and sell side of the transaction is entered into within six months of the other.[88]Currently, to further make the insider trading regulations in India more efficient in the context of its specific business environment, intermediaries in the capital markets like underwriters, lawyers, auditors have been required to comply with Part B of the first Schedule of the SEBI (Insider Trading) Regulations, 1992. But clearly the regulation of these other entities is overworked and overregulated at times and operationally impossible at other times. To give an example, practically every law firm advises listed companies. To have a compliance officer in every firm and monitoring of trades by each employee is completely unworkable, and hence,even partial compliance will never happen. This is coupled with penalties of 10 (ten) years in jail, suspension, fines, etc. Hence, these 'corporate governance' penalties for non corporate professionals should be removed because adequate remedies are in place for members who are likely to cause comparatively higher substantial damage by resorting to insider trading.[89]

NEED FOR MANDATORY FORENSIC AUDIT IN INDIA COMPANIES

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[87]*Rakesh Agrawal* v. *Securities and Exchange Board of India*, [2004] 49 SCL 351

[88]*Supra* note 81 at 24

[89] *Supra* note 81 at 24

Accounting corporate frauds are results of manipulation of accounts and accounting jugglery designed to deceive others for wrongful gains. In all major accounting scandals such as the ones witnessed in the scandals involving Enron, Worldtel and Parmalat, the methods and purpose of manipulations in financial statements were peculiar to the motives of such manipulations.[90] Quite often when a company makes losses in its books, the true picture of the business is much healthier because of the profits which are in the form of black money. It is a standard joke among bankers in India that, there are many financially sick companies but no financially sick promoters.[91]

In India, under the Companies (Auditor's Report) Order, 2003, it is required that auditors report the information as to whether any fraud on or by the company has been noticed or reported during the year. External auditors look at the numbers but the forensic auditors look beyond the numbers.[92]. The main object of audit is to find out after going through the books of accounts, whether the balance sheet and profit & loss account are properly drawn up according to the relevant stautory framework and whether they represent true and fair view of the state of affairs of the concern. But forensic auditing is a new concept of investigation. It involves analyzing, testing, inquiry and examining the civil and criminal matters and finally giving an unbiased and true report.[93]

"Forensic audit" as a term has not been defined anywhere. On one hand if the concept of financial auditing may be defined as a concentrated audit of all

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[90]S. Vasudevan, *Forensic Audting- An Introduction*, http://cab.org.in/CAB%20Calling%20Content/FORENSIC%20AUDIT%20IN%20BANKS/Forensic%20Audit%20-%20An%20Introduction.pdf, visted on July 23, 2013.

[91] *Id.* at 27

[92]Lalita B. Malusare, *The Effectiveness of Forensic Accounting in Detecting, Investigating and Preventing Frauds in India* , http://www.oiirj.org/oiirj/may-june2013/26.pdf, visted on June 21, 2013.

[93]*Id.* at 27

the transactions of the entity to find the correctness of such transactions and to report whether or not any financial benefit has been attained by way of presenting an unreal picture, the concept of forensic auditing aims at the legal determination of whether a fraud has actually occurred. The object of such audit is to relate the findings of audit by gathering legally tenable evidence and in doing so the corporate veil may be lifted (in case of corporate entities) to identify the fraud and the persons responsible for it and to find out whether or not true business value has been reflected in the financial statements and in the course of examination to find whether any fraud has taken place. Fraud and forensic accounting seems to be the need of the hour which helps in detecting corporate frauds, arresting business leakages, and to check compliance with the larger corporate governance norms.[94] Hence forensic audit should be made mandatory in India for all companies which are running losses and not only to those which have essentially been found to be the ones with improper corporate governance mechanism in place.

It should be remembered that the approach of forensic audit is to unearth evidence of wrongdoing; hence, it needs a combined team of people from the police or the Central Bureau of Investigation, lawyers and audit professionals with an adversarial approach. These steps will bring to light frauds, if any, much more quickly, but will not stop them. The Institute of Chartered Accountants of India's disciplinary board needs to be expanded; and work expedited and publicized to gain public confidence. For large value cases like Satyam, special benches need to be constituted for expeditious decisions. Given the strategic importance of internal auditors, Companies Act, 2013 should mandate that internal auditors and valuers must be members of the Institute of Chartered

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[94] *Id.*. at 27

Accountants of India, subject to their professional ethics and regulatory discipline.[95]Additionally, a strong knowledgeable audit committee and its chairman are the best bulwark whenever promoters' opinion differs from that of the auditors.

NEED FOR EFFECTIVE ENFORCEMENT BY REGULATORS

In the high-profile case involving refund of over Rs. 24,000 crore to the bondholders of two Sahara companies, SEBI had passed orders for attachment of various properties and freezing of accounts after the entities failed to deposit the entire money. The regulator has already asked the Supreme Court to allow it to appoint an Officer of Special Duty and other officers to deal with the objections and claims relating to the property to be sold and forconducting the sale of the property to garner funds for refunding the investors'money.[96]But, SEBI has been repeatedly criticized for its usual delay in taking enforcement actions in many other cases.[97]This scenario is a huge disadvantage to India's legal system relating to listed entities, as it effectively relies upon public enforcement by SEBI, and altogether, excludes private enforcement by shareholders (specifically, if they are a part of the minority), thereby limiting the remedies they can avail. For example, when the Satyam scam came into the public domain in early 2009, it was followed by frenetic regulatory action. But there were hardly any effective private shareholder actions in India, either by the institutional investors or retail investors as opposed to the successful claims

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[95]K S Mehta, *Audit Lessons to Learn From Satyam*, http://www.rediff.com/money/2009/jan/31satyam-audit-lessons-to-learn-from-satyam.htm, visted on June 12, 2013.
[96]*Sahara Freeze Order Gets SEBI Rs. 52 Cr in Cash, Investments*, THE HINDU, June 23, 2013
[97]*SEBI Seeks Sweeping Powers*, LIVE MINT AND THE WALL STREET JOURNAL, May 22, 2013

made by U.S shareholders in the courts in U.S.[98] On the other hand, Indian companies such as Infosys and Ranbaxy have been hauled up in foreign jurisdictions for their non-compliance with the domestic laws of U.S.[99] This situation portrays a contrast which exists between the enforcement mechanism of India and developed economies, like the U.S. It however remains to be seen as to how will SEBI utilize the additional rights vested on it going forward under the Securities Laws (Amendment) Ordinance, 2013.

CONCLUSION

As the face of Indian business is changing, one cannot do business and remain insulated from governance expectations of stakeholders in corporates such as the customers, investors and bankers. Simultaneously, governance has to be consistent, constant and dynamic enough to change and keep pace with a company's business expectations and markets which they are looking to operate in. So, there is really no choice for a corporation but to comply with the relevant governance norms and as such these norms cannot be applied in a discretionary manner as and when the company desires, as they are integral to the company as the business itself.

As discussed already, the levels of corporate governance in a company has been established to be directly proportional to the investment it is capable of attracting in the long run. The larger compliance set-up to which a company

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[98]Umakanth, *The Advent Of Shareholder Activism In India*, papers.ssrn.com/sol3/papers.cfm?abstract_id=2165162, visted on June 15, 2013.

[99] *Ranbaxy to pay $420,000 in US for Sub-Standard Drugs,* TIMES OF INDIA , July 9, 2013; and *Infosys in talks with US over visa row*, TIMES OF INDIA, October 11, 2013.

needs to adhere to might remain largely the same over years, while the change in the management of the company might be a more frequent phenomenon.

Hence, it must always be remembered that irrespective of who is a part of the management of a company at any given point of time it must be ensured that a company always aims at attaining and retaining high levels of corporate governance, in light of the returns it can yield on the long run. But, unlike in the public sector, in the private sector, transparency is ensured to the stakeholders of the company to a much lesser extent.[100] Hence, we need a complete revamp of the private justice system in India wherein policies such as the whistle-blower's policy should be made mandatory and other governance related policies are enforced more stringently.

It is interesting to note that usually criminals have never been deterred by strong laws and collusive fraud is even more difficult to uncover, especially, if there is comprehensive paperwork to support it; but, over a period of time, it can be detected by a common sense approach instead of a mechanical approach. As discussed above, in India, one of the biggest roadblocks to enforcement of corporate governance is the ineffectiveness of the enforcement mechanism with respect to enforcement of contracts by courts and enforcement of corporate governance norms by the regulatory bodies.The delay and lack of seriousness in such enforcement is the pressing need to be addressed by the existing legal regime. The same can be achieved by setting up special courts which look into enforcement of contracts involving any corporate. The judges appointed to hear such matters should be specifically trained to deliver the judgments by keeping the larger market implications affecting the parties in mind and should be financially literate along with having a very sound knowledge of the manner in

[100] *Supra* note 56 at 18, Rego

which such contracts can be enforced effectively. Additionally, SEBI should report non-compliance or any irregularities by a company to other government enforcement agencies regulating corporations, such as Reserve Bank of India, Income Tax Department, Financial Intelligence Unit, etc., which can deal with corporate frauds, as currently, there is no mechanism for sharing of such leads, information and intelligence of one government enforcement agency with another and as a result corporate fraudsters are being let off as the significant warning signs are being missed.[101]Regulatory bodies such as SEBI which are very closely involved with the supervision and enforcement of corporate governance norms should ensure that such enforcement and supervision happens in a time bound manner and is not restricted to mere statutory compliance of such corporate governance norms by the companies, but in spirit as well. Also, a number of ideas in order to make Clause 49 more dynamic and effective have been outlined in this article, (See Section VII), which, if implemented, will go a long way in establishing and institutionalizing healthy corporate governance practices in India.

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[101]Aseem Chawla, *Deter Coprorate Fraud:-Need of the Hour*, Legal Era, July 2013, Vol IV, Issue V, at 30.

IS CORPORATE SUCCESSION PLAN IMPORTANT? READING FROM INDIA

- Dr. Indrajit Dube[1] & Mr. Sunil Phatak[2]

ABSTRACT

Top Leadership of a corporate entity are the captains whose leadership skills and vision drive the corporate entity every day, be it day-to-day operations or long-term strategies for business. The fortunes of a corporate entity rise or fall based on the decisions taken by the top leadership. The paper attempted to analyze the practice and impact of corporate succession from the perspective of corporate governance in reference to some of the Indian Corporate Conglomerates.

INTRODUCTORY NOTE

Corporates have today become integral parts of society. In India, economic liberalization, the shift from a predominantly agrarian economy to an industrial, manufacturing and services based economy and widening of the capital markets have been key contributors in this integration in the last two decades. The result is that today, a large body corporate does not stand or fall alone. Wider society is a stakeholder in its fortunes and thus issues that affect a company are of interest to society as well. This company-society integration has led to a focus on corporate governance with a view to promote greater transparency and accountability in the conduct and decision making of the company's top leadership as well as to provide safeguards against abuse of power[3].

[1] Associate Professor, RG School of IP Law, IIT Kharagpur
[2] Associate Consultant,TCS Ltd.
[3]Dube, Indrajit: *Corporate Governance,*LexisNexis, ButterworthsWadhwa, Nagpur, 2009.

The Securities and Exchange Board of India (SEBI) Committee on Corporate Governance defines corporate governance as the "acceptance by management of the inalienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It is about commitment to values, about ethical business conduct and about making a distinction between personal & corporate funds in the management of a company."[4]

Good corporate governance involves a set of guiding principles, processes based on the principles and systems for implementing the processes, to ensure commitment to values and ethical conduct of business; transparency in business transactions; statutory and legal compliance; adequate disclosures and effective decision-making to achieve corporate objectives in the best interest of all stakeholders. Corporate governance promotes fairness, transparency and accountability.

Top leadership of a corporate entity are the captains whose leadership skills and vision drive the corporate entity every day, be it day-to-day operations or long-term strategies for business[5]. The fortunes of a corporate entity rise or fall based on the decisions taken by the top leadership. In this context, top management succession attracts considerable interest from scholars as well as society.

On the Indian corporate canvas, we can see two types of companies; a sizeable number of companies are managed by professionals and at the same

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[4]*Report of the SEBI Committee on Corporate Governance* (SEBI Committee on Corporate Governance, February 2003 Accessed from http://www.sebi.gov.in/commreport/corpgov.pdf, Last Visited February 2013.

[5]Pamela S. Tolbert and Richard H. Hall:*Organizations: Structures, Processes, and Outcomes* (Pearson Prentice Hall, New Jersey, Tenth Edition, 2009).

time, we have a large number of family-owned or controlled enterprises which typically see dynastic leadership. Consequently, it is observed that there are two dominant forms of top management successions - first where future leaders are cultivated from among the professionals within the organization, and second where the leadership succession is through inter-generational family succession.

RESEARCHERS THOUGHTS

Researchers in the past pondered over the matter of corporate succession from the different perspectives. Present paper attempted tothe represent those thought in a systematic manner. This will provide the prospective of the present study and place the subsequent argument of this paper in the context.

The Role of Board of Directors in CEO Succession: Theory and Evidence: Qianru Qi -

The author develops a search-matching model for chief executive officer (CEO) selection and finds significant advantages of a good match. The author also found significant benefits to firms that had adopted a CEO succession plan. Further, the study finds that boards with more independent directors picked CEOs with higher match qualities[6] and the time boards spent on screening candidates played a role in CEO succession.

The Role of the Independent Director in CEO Supervision and Turnover: Salvador Plaza, Guido Stein -

The authors focused on the role played by the independent directors in supervision of CEOs and in CEO succession. The authors found that the

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[6]Qianru Qi: *The Role of Board of Directors in CEO Succession: Theory and Evidence*, Last visited March 2011. Available at SSRN: http://ssrn.com/abstract=1786545, (last visited January 2013).

effectiveness of the independent directors in their role was driven by personal qualities and further, the independent directors showed evidence of greater say in the matter of replacement of CEOs when they enjoyed effective independence[7].

The Linkages between Corporate Governance and CEO Succession: A Theatrical Episode, a Theoretical Framework and an Analytical Model: AnandSaxena, A. T. Deb, Mukesh K.Mehlawat -

In this study, the authors examine CEO succession from both theoretical and analytical perspectives with a three-pronged approach of case method, a modified Structure-Conduct-Performance (S-C-P) analysis and finally a simulation of the Analytical Hierarchy Process (AHP) with a view to delineating the relative strength (weights) of the various performance related, process related and antecedent related variables impinging upon CEO succession and posits succession as a governance issue[8].

Corporate Governance Norm for SME: Dr. Indrajit Dube, Dr. Dipa Dube, Dr. Pulak Mishra -

The authors conducted an extensive survey of small and medium enterprises (SMEs) in India to assess the adoption of corporate governance and provide in-depth recommendations on various parameters. They found that succession in organizational leadership is the most important challenge SME's face in absence

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[7]Guido Stein and Salvador Plaza:*The Role of the Independent Director in CEO Supervision and Turnover,*(IESE Business School Working Paper No. 133, Available at SSRN: http://ssrn.com/abstract=1782707,Last visited January 2011).

[8]AnandSaxena, A. T. Deb,Mukesh K. Mehlawat:The Linkages between Corporate Governance and CEO Succession: A Theatrical Episode, a Theoretical Framework and an Analytical Model,*SSRN,*(January 2010. Available at: http://ssrn.com/abstract=1539239, last visited March 2013).

of separation of ownership and management and failure of proper planning[9]. Therefore, a significant recommendation was to have a well-defined "Enterprise Succession Plan" in place.

Institutionalized Action and Corporate Governance: The Reliance on Rules of CEO Succession: William Ocasio -

In this study, the author has followed an institutional theory of action to explore the consequences of formal and informal rules on the chief executive officer (CEO) succession process. The author analyzes both insider as well as outsider CEO succession in U.S. industrial corporations' context and finds that boards rely on both past precedents and formal internal labor markets for executive succession and the selection of insiders versus outsiders as CEOs[10].

Critical factors in leadership succession: Gil E Gordon, Ned Rosen -

The authors have reviewed the relevant literature pertaining to the dynamics of the succession process and their indirect implications for leadership and group effectiveness and tried to evolve a model of leadership succession, based on prior research, group process literature, and logical analysis[11] in the human psychology context.

An investigation of corporate leadership succession planning and implementation: the Malaysian experience: John P G Tan -

In this thesis, the scholar examined the actual process of leadership succession in the Malaysian context on the qualitative aspects and found that Malaysian

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[9]Dr. Indrajit Dube, Dr. Dipa Dube, Dr. Pulak Mishra:Corporate Governance Norm for SME, *Journal of Public Administration and Governance*, (Vol. 1, No. 2, 2011).

[10]William Ocasio: Institutionalized Action and Corporate Governance: The Reliance on Rules of CEO Succession,*Administrative Science Quarterly*, Vol. 44, No. 2 pp. 384-416, Johnson Graduate School of Management, Cornell University, (Available at http://www.jstor.org/stable/2667000, Last visited June 1999).

[11]Gil E Gordon, Ned Rosen:Critical factors in leadership succession, *Organizational Behavior and Human Performance*, Volume 27, Issue 2, Pages 227–254, (April 1981).

companies were not engaged in leadership succession planning and implementation and the few that had such processes reported low success rates indicating an infancy stage in leadership succession planning and implementation among Malaysian companies. An interesting aspect of this study is that it deals with family-controlled publicly listed companies as such companies constitute the majority of publicly listed companies in Malaysia. This is of significant interest to the present study as India too has a large number of such companies. The study found that in such companies, dynastic succession was the predominant form of CEO succession and the CEO's position was the preserve of members of the founding family[12]. This research also shows that leadership succession processes are greatly influenced by cultural factors and that leadership succession models must take into account cultural effects.

Succession Planning: Does it Matter in the Context of Corporate Leadership? : Patricia Richards -

The author draws upon institutional case studies and interviews with CEOs to report on a tendency for chief executive officers not to take much notice of leadership development and succession processes when making appointments to their own senior leadership teams, instead focusing primarily on likely impact of a leadership appointment on corporate profitability[13].

PARAMETERS OF LEADERSHIP SUCCESSION

Present paper of leadership succession was conducted by examining the process of leadership succession in the companies selected for case analysis on a

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[12] John P G Tan:*An investigation of corporate leadership succession planning and implementation : the Malaysian experience* (Doctoral Thesis submitted for the degree of Doctor of Philosophy in Management, Massey University, 2009, Available at http://mro.massey.ac.nz/handle/10179/1095,Last visited March 2013).

[13]Patricia Richards: Succession Planning: Does it Matter in the Context of Corporate Leadership? *Australian Journal of Adult Learning*, V48N3p445-464 (Nov 2008), Available at http://www.eric.ed.gov/PDFS/EJ828984.pdf, last visited March 2013.

common set of parameters. A background literature analysis was conducted to prepare a set of parameters that have been observed to be significant in related studies in the past. These parameters are described below:

Is there a systematic succession strategy in place?

In the background survey, it was found that best-practice organizations make succession planning an integral corporate process by exhibiting a link between succession planning and overall business strategy. This link gives succession planning the opportunity to affect the corporation's long-term goals and objectives.[14] Best-practice organizations use a cyclical, continuous identification process to focus on future leaders.[15] With a succession plan in hand, the Board can act quickly and confidently. A ready plan also promotes shareholder value with a stronger leadership team across the organization.[16] However, it must be duly noted that planning well ahead and having a chosen successor ready and waiting, though better than not doing so, is no guarantee that the successor will actually be a success.[17]

Origin of Successor: is the Candidate In-House or Outsider?[18]

Identifying internal candidates as well as considering external potential candidates are both world-wide best practices.[19] This is a critical factor in choosing the successor since the acceptance of a leader who is perceived as an

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[14]Robert Fulmer: Choose Tomorrow's Leaders Today: Succession Planning Grooms Firms for Success,Accessed from http://gbr.pepperdine.edu/021/succession.html, Last visited March 2013.

[15]*Ibid.*

[16]A.T.Kearney, *Filling the CEO's Chair: Creating and Implementing CEO Succession Strategies* (White Paper), available at http://www.atkearney.com/documents/10192/11f2bcb1-5c89-4b11-9e08-74d27ff5abb1, Last visited March 2013.

[17]*Business: The Big Mac Succession: Face Value,* The Economist 371:8372 (2004), p74.

[18]*How General Electric Planned the Succession*, Human Resource Management International Digest 9:4 (2001), pp.6–8.

[19]*Id.*

outsider will need a supporting organizational culture which is willing to accept such a candidate. Organizational size is a significant factor that may have influence on executive succession patterns. Past studies worldwide have reported that large companies were more likely to opt for insider successors than the smaller ones.[20]

The origin of a successor has been singled out in succession studies. Insider successions have typically been found to be less disruptive and less likely to lead to deterioration in performance that outsider succession. Others, however, suggest that outsider succession will more likely lead to corporate growth.[21] Literature also suggests that publicly looking outside organizational ranks for a leader is interpreted by some analysts as evidence of management weakness within.[22]

National cultural differences do play a role in effective succession planning practices. It is acknowledged world-wide that some firms in developing nations will prize "family heritage". Family businesses represent a special succession challenge for the simple reason that many factors come into play and the key management issue has to do with answering this question: "Who is best equipped to run the business when the founder passes from the scene?"[23] Thus, the origin of the successor is a complex and critical factor in leadership succession.

How are the potential successors assessed?

Once potential candidates have been identified, the next consideration is

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[20]Worrell, D. L. and W. N. Davidson III: *The Effect of CEO Succession on Stockholder Wealth in Large Firms Following the Death of the Predecessor,* Journal of Management, Volume 1 Issue 3, (1987), p.509.
[21]*Supra note* 16.
[22] See *Supra note*.17.
William J. Rothwell: *Effective Succession Planning: Ensuring Leadership Continuity and Building Talent from Within,* AMACOM, 3rd Edition, (2005),pp.49-52.

how are the candidates evaluated? In the background survey, it is observed that best-practice organizations use a core set of leadership and succession management competencies in identifying the future leadership candidates.[24] The survey also suggests that it is advisable to develop descriptions of the values and ethical standards required and assess people relative to those as well as competencies.[25]

Every organization will have its unique needs when choosing a new leader; even though there will be a number of common parameters. The background survey suggests that it is a best practice to assess individual candidates' strengths and weaknesses compared to the organization's needs.[26] Interestingly, one of the most reliable indicators for successful performance in the future is a successful track record.[27] In the case analysis, we will examine the presence of a core set of criteria for assessment of candidates.

What were the conditions surrounding the succession?

This is a critical factor as 'the consequences of succession are likely to vary dramatically depending on the conditions surrounding them.'[28] The conditions applicable to succession upon the retirement or superannuation of the incumbent leader, the conditions applicable to succession upon the death of the predecessor, the conditions applicable to sudden departure of the incumbent leader, or the conditions applicable to a forced ouster of the

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[24]See *Supra note*.14.
[25]William J. Rothwell: *Effective Succession Management: Building Winning Systems or Identifying and Developing Key Talent,* Lexington, Mass.: The Center for Organizational Research. Retrieved from http://www.cfor.org/News/ article.asp?id=4. Last visited May 2013.
[26]*Succession Management: Filling the Leadership Pipeline,* Chief Executive, (April 2004), pp.1-4.
[27] *Supra n*ote.15.
[28] *Supra n*ote.19.

incumbent by shareholders, institutional investors, lenders or regulatory authorities are all quite distinct from one another.

The financial health and business performance of the company is also a critical condition factor that influences the choice of the successor. It has been argued that 'outsiders are brought in to promote change and creativity, whereas insiders are chosen to maintain the current system and provide stability'.[29] Thus, it is worthwhile to factor in the conditions under which the leadership succession has taken place.

What is the role played by incumbent leader and Directors, particularly Independent Directors in the succession process?

In background analysis, it was seen that best-practice organizations ensure hands-on involvement by the CEO and other senior leaders.[30] Recent events across the world, including corporate scandals like Enron, WorldCom and Satyam have increased focus on the role played by the Board of Directors. Developments like the Sarbanes-Oxley Act, 2002 in the U.S.have made the boards more accountable in business operations[31] and prompted them to take a more active role in succession issues.[32]

Time spent in getting to know the candidate and evaluating his/her abilities[33] by the board members is a data point that is of interest – some boards evaluate the candidates in a focused activity while others spend years observing

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[29] *Supra n*ote.19.
[30] *Supra n*ote.24.
[31]William J. Rothwell: *Effective Succession Planning: Ensuring Leadership Continuity and Building Talent from Within,*AMACOM, 3rd Edition, 2005, p.48.
[32] Dale Buss: *Corporate Compasses* (HR Magazine 49:6 (2004)) pp.127–128, 130, 132, see also, Robert Grossman: *HR on the Board,* HR Magazine 49:6 (2004), pp.56–63.
[33]*How General Electric Planned the Succession,*Human Resource Management International Digest 9:4 (2001), pp.6–8.

potential candidates and assessing their abilities and performance. Further, once a final, manageable set of potential candidates has been identified, does the board invest in focused leadership skills development of these candidates? This is relevant in cases of succession where the board has relatively longer time to plan and execute succession.

Lastly, what is the role played by the incumbent leader post-succession? Does the previous leader retire and dissociate completely or stay on in a non-executive role to mentor and guide the successor? This is a relevant factor to consider while analyzing leadership succession.

APPROACH UNDERTAKEN

The case analysis for this study uses the annual reports published by the companies as the primary source of data coupled with the corporate profile data available on the respective company's website as a supplementary source of data.

For each case study, taking the financial year in which the leadership transition occurred as the base year, this study takes the annual reports of preceding three years and subsequent three years as the data set to be analyzed to understand how the succession was undertaken and its effects in the immediate future. Three years limit was chosen to narrow down the scope to relevant developments.

Choice of Companies for Case Study Analysis

The issues of leadership succession and their interplay with principles of corporate governance are vast in their scope and complexities. In order to conduct a manageable study, the scope of the case study analysis has been limited to three companies, namely Bajaj Auto Ltd., ICICI Bank Ltd. and Tata

Consultancy Services Ltd. These three companies were chosen based on following considerations:

Recent Leadership Succession

This study looks at companies that have seen leadership succession in the recent past for limiting the scope of this study. While choosing the companies, this period was defined as last 10 years so as to have a more contemporary assessment. All the three case studies chosen have had top leadership succession in the last decade.

Leadership Succession by way of retirement of predecessor

While selecting the companies for this study, it was decided to limit the scope to companies that had leadership succession by way of retirement of the incumbent leader followed by a new leader succeeding him. There are other extra-ordinary situations such as the sudden demise of the incumbent or the incumbent being replaced by key stakeholders in an unplanned manner. Such unplanned leadership changes are distinct in their impact from the above anticipated leadership succession and need to be studied on their own. Due to this choice, other significant corporate leadership changes such as those at Reliance Industries and Aditya V Birla group were not considered for this study. All the three companies chosen for this study have had well-anticipated changes in leadership due to retirement of the incumbent leader due to superannuation.

Public-listed Companies

This study has chosen to limit the scope to public-listed companies for three reasons - first, private companies, unless very large in size, do not have as wide an impact as public listed companies have on economy and society. With the

involvement of retail and institutional shareholders and lenders, public listed companies have a much wider impact whereas in private companies, primarily the promoters will be impacted by leadership succession. Secondly, promoters have absolute say in leadership succession in private companies which may or may not be true in public-listed companies even with the presence of dominant promoter holdings and the markets exert their own forces on such decision-making. Lastly, the regulatory requirements for corporate governance, disclosures and reporting are largely different for public and private companies in the Indian corporate law framework. Due to reporting requirements, it is fairly easy to obtain reported data for public companies while it is almost impossible to find publicly accessible data on private companies. This access to data is critical for the purposes of this study.

Size of the Company

Leadership succession has very strong impact on all organizations whether they are small, mid-sized or large. For the purpose of this study, companies that are large in size by market capitalization and are leaders in their respective industrial sectors have been chosen.

Industrial Sectors

It was decided to analyze cases from different industrial sectors to gain a better understanding. Consequently, this study has chosen the companies for case study from different industrial sectors. Bajaj Auto Ltd. is a company that manufactures automobiles and is a leader in two-wheeler automobiles. ICICI Bank Ltd. is a private sector banking company and one of the top four banks in India. Tata Consultancy Services Ltd. provides information technology services to clients across the world and is the largest IT services company in India and

among the top ten across the world.

CASE STUDY 1: BAJAJ AUTO LTD.

Corporate Profile

Bajaj Auto Limited is a manufacturer of scooters, motorcycles and three-wheeler vehicles and spare parts thereof.[34] The company operates in two segments: automotive and investments. It is ranked as the world's fourth largest two- and three- wheeler manufacturer. The company is well known for their research and development (R&D), product development, process engineering and low-cost manufacturing skills. The company is the largest exported of two and three-wheelers in the country with exports forming 18% of its total sales. The company has two subsidiaries, namely Bajaj Auto International Holdings BV and PT Bajaj Indonesia. The company was incorporated on April 30, 2007 as a wholly owned subsidiary of erstwhile Bajaj Auto Ltd (the holding company) with the name Bajaj Investment & Holding Ltd. The company received the certificate of commencement of business on May 7, 2007. The holding company operated in the segments, such as automotive, insurance and investment, and others.

Considering the growth opportunities in the auto, wind-energy, insurance and finance sectors, the holding company de-merged their activities into three separate entities, each of which can focus on their core businesses and strengthen competencies. The auto business of the holding company along with all assets and liabilities pertaining thereto including investments in PT Bajaj Auto Indonesia and in a few vendor companies transferred to Bajaj Investment & Holding Ltd. In addition a total of Rs. 15,000 million in cash and cash

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[34] *About Bajaj,* Accessed from http://www.bajajauto.com/bajaj_corporate.asp, Last visited February 2013.

equivalents also transferred to Bajaj Investment & Holding Ltd. As the part of the scheme, Bajaj Holdings and Investment Ltd were renamed as Bajaj Auto Ltd.[35]

In November 2007, Bajaj Auto International Holdings BV, a wholly owned subsidiary company acquired 14.51% equity stake in KTM Power Sports AG of Austria, Europe's second largest sport motorcycle manufacturer for Rs 345 crore. The company plans to maintain the capacity of two and three-wheelers at the current level of 5,040,000 numbers per annum during the year ending 31 March 2012. The 4 wheel vehicle development work is under progress and commercial launch of the first product from this platform is expected soon.[36]

Leadership and Succession

The formal succession of the managing director's office was in April 2005.The incumbent managing director prior to succession, Rahul Bajaj, took charge of the business in 1965 and became the managing director in 1968 at the age of 30. He holds an Honours Degree in economics from Delhi University, a degree in law from Bombay University and an MBA from Harvard Business School. He is currently the chairman of Bajaj Auto Ltd.[37]

The successor, Rajiv Bajaj graduated first in class, with distinction, in mechanical engineering from the University of Pune in 1988, and then completed his masters in manufacturing systems engineering, with distinction,

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[35] *Bajaj Auto Ltd. Background Company profile* – IndiaInfoline.com, Accessed from http://www.indiainfoline.com/Markets/Company/Background/Company-Profile/Bajaj-Auto-Ltd/532977, lastvisited February 2013.

[36] *Company Profile for Bajaj Auto Ltd.* – Reuters India, accessed from http://in.reuters.com/finance/stocks/companyProfile?symbol=BAJA.BO, last visited January 2013.

[37] *Rahul Bajaj – Board of Directors – Bajaj Auto Ltd.*,Accessed from http://www.bajajauto.com/profile/profile_rahulbajaj.html, last visited March 2013.

from the University of Warwick in 1990. He also holds MBA from Harvard University. He is a post-graduate in management and holder of an International Certificate for Financial Advisors from the Chartered Insurance Institute, London. He also pursued an executive MBA in International Wealth Management under an exchange program between University of Geneva, Switzerland and Carnegie Mellon University, Pittsburgh, USA.[38]

Rajiv Bajaj has worked at Bajaj Auto Ltd. in the areas of manufacturing andsupply chain (1990-95 as officer on special duty), R&D and engineering (1995-2000 as general manager and vice president), and marketing and sales (2000-2005 as president and joint managing director). He is acknowledged to have contributed to and participated in the successful transition of Bajaj Auto Ltd. to a high quality manufacturer of high performance motorcycles by conceiving and executing a realistic and result-oriented plan that has always secured profitability. Having obtained extensive on-the-job experience in Bajaj Auto, he has been leading for more than a decade a major technological and marketing reorientation, so as to meet the existing and future competitive challenges. He has been spearheading Bajaj Auto's transition from a predominant scooter and three-wheeler manufacturer to a formidable force to reckon with in the motorcycle segment as well in the areas of product design, development, manufacturing and marketing. To his credit, amongst others, goes the setting up of Bajaj Auto's ultra-modern plant at Chakan (near Pune) and the in-house design and development of the 'Pulsar' and 'BYK' range of motorcycles. He has also played a pivotal role in revamping the supply chain and the marketing set-up in Bajaj Auto and in introducing innovative strategies to provide a cutting edge. He took over as the managing director in April 2005 at

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[38] *Rajiv Bajaj – Board of Directors – Bajaj Auto Ltd.*, Accessed from http://www.bajajauto.com/profile/profile_rajiv.html, last visited January 2013.

the age of 38.[39]

Succession Analysis

Bajaj Auto Ltd. is a family-controlled, public-listed company. It has a tradition of Bajaj family members being in leadership and director positions. The previous leader had a very long tenure at the leadership position in the company. The successor is his son and represents the next Bajaj family generation at the helm of the company.

The publicly available data in the form of annual reports does not indicate the presence of a systematic succession strategy being in place at Bajaj Auto Ltd.

The successor, *prima facie*, is a family member and indicates inter-generational succession. However, further data indicates that the successor, before taking up leadership position, has been associated with the company in various roles and has a performance track record. This also indicates grooming of potential successor for the leadership role.

There is no publicly available data to indicate objective assessment parameters for assessing candidates. However, the successor appears to have been assessed through various roles within the organization and his performance in those roles.

The leadership succession at Bajaj Auto Ltd. was a planned succession with the incumbent leader scheduled to retire.

The incumbent leader has continued his association with the company in the chairman's

[39] *Rajiv Bajaj –Executive Profile & Biograph,* Business week accessed from http://investing.businessweek.com/research/stocks/people/person.asp?personId=8400919&ticker=32669680, last visited March 2013.

position in a non-executive capacity. This also fits his position as the family patriarch. This indicates guiding and mentoring of the new leader.

The successor leader has displayed maturity by not chasing the volume numbers leadership and instead focusing on leadership in profit. Consequently, Bajaj Auto Ltd. displays strong profitability numbers under the successor's leadership.

The successor has focused on making Bajaj Auto Ltd. a leader in various segments it operates in. He is credited with introducing new models and creating market segments. Bajaj Auto Ltd. has continued to introduce new and innovative product models. Further, Bajaj Auto Ltd. has made foreign collaborations and acquisitions resulting into performance product models in price segments which were so far considered as part of four-wheeler market. The company also plans to enter four-wheeler market, with a product launch expected in the near future, and is creating a new quadricyclemarket which so far did not exist in India.

CASE STUDY 2: ICICI BANK LTD.

Corporate Profile

ICICI Bank Ltd is a major banking and financial services organization in India. ICICI Bank is the second largest bank in India and the largest private sector bank in India by market capitalization. ICICI Bank Ltd was incorporated in the year 1994 as a part of the ICICI group with the name ICICI Banking Corporation Ltd.[40]

The bank, together with its subsidiaries, joint ventures and associates, is

[40] *ICICI Bank Ltd. Background Company profile – IndiaInfoline.com,* Accessed from http://www.indiainfoline.com/Markets/Company/Background/Company-Profile/ICICI-Bank-Ltd/532174, last visited February 2013.

a diversified financial services group providing a range of banking and financial services, including commercial banking, retail banking, project and corporate finance, investment banking, broking and treasury products and services. It operates under four segments: retail banking, wholesale banking, treasury and other banking. Retail banking includes exposures, which satisfy the four criteria of orientation, product, granularity and low value of individual exposures for retail exposures. Wholesale banking includes all advances to trusts, partnership firms, companies and statutory bodies, which are not included under retail banking. Treasury includes the entire investment portfolio of the bank. Other banking includes hire purchase and leasing operations and other items.[41]

ICICI Bank offers a wide range of banking products and financial services to corporate and retail customers through a variety of delivery channels and through its specialized subsidiaries in the areas of investment banking, life and non-life insurance, venture capital and asset management. The bank has a network of 3,121 branches and 10,486 ATMs in India, and has a presence in 19 countries, including India. The bank currently has subsidiaries in the United Kingdom, Russia and Canada, branches in United States, Singapore, Bahrain, Hong Kong, Sri Lanka, Qatar and Dubai International Finance Centre and representative offices in United Arab Emirates, China, South Africa, Bangladesh, Thailand, Malaysia and Indonesia. Its UK subsidiary has established branches in Belgium and Germany.

ICICI Bank's equity shares are listed in India on Bombay Stock Exchange Limited (BSE) and the National Stock Exchange of India Limited (NSE) and its americandepositary receipts (ADRs) are listed on the New York

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[41]*Company Profile for ICICI Bank Ltd. – Reuters India,* accessed from http://in.reuters.com/finance/stocks/companyProfile?symbol=ICBK.BO, last visited February 2013.

Stock Exchange (NYSE).[42]

Leadership and Succession

The succession for the managing director and CEO's office was in May 2009.The incumbent managing director prior to succession, Mr. K. VamanKamath has a degree in mechanical engineering and did his management studies at the Indian Institute of Management, Ahmedabad.

Mr. Kamath started his career in 1971 at ICICI, an Indian financial institution that founded ICICI Bank and merged with it in 2002. In 1988, he moved to the Asian Development Bank and spent several years in South-East Asia before returning to ICICI as its managing director & CEO in 1996. Under his leadership, the ICICI group transformed itself into a diversified, technology-driven financial services group that has leadership positions across banking, insurance and asset management in India, and an international presence. He retired as managing director & CEO in April 2009, and took up his present position as non-executive chairman of the board of directors of ICICI Bank.[43]

The successor, Ms. Chanda Kochhar began her career with erstwhile ICICI Limited in 1984 and was elevated to the board of directors of ICICI Bank in 2001. She was instrumental in establishing ICICI Bank during the 1990s, and subsequently headed the infrastructure finance and corporate banking business in ICICI Limited. In 2000, she took on the challenge of building the nascent retail business, with strong focus on technology, innovation, process reengineering and expansion of distribution and scale. The bank achieved a leadership position in this business.

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[42]*ICICI Bank – About Us,* Accessed from http://www.icicibank.com/aboutus/about-us.html, last visited March 2013.

[43]*Mr. K. V. Kamath – ICICI Bank – About Us – Director's Profile,*Accessed from http://www.icicibank.com/aboutus/board-of-directors-kv-kamath.html, last visited March 2013.

During 2006-2007, she successfully led the bank's corporate and international banking businesses during a period of heightened activity and global expansion by Indian companies. From 2007 to 2009, she was the joint managing director & Chief Financial Officer during a critical period of rapid change in the global financial landscape. She was elevated as managing director & CEO of ICICI Bank in 2009 and is responsible for the bank's diverse operations in India and overseas. She also chairs the boards of the bank's principal subsidiaries, which include India's leading private sector life and general insurance companies.

Ms. Kochhar is widely recognized for her role in shaping the retail banking sector in India and for her leadership of the ICICI group, as well as her contributions to various forums in India and globally. She was conferred with the Padma Bhushan, one of India's highest civilian honours, in 2011.[44]

Succession Analysis

ICICI Bank Ltd. has been a professionally-managed company. It is neither family-owned nor family-controlled and was formerly a Government of India undertaking before becoming a private bank.

The publicly available data in the form of annual reports does not indicate the presence of a systematic succession strategy being in place at ICICI Bank Ltd.

The successor comes from the ranks of the organization and has had a long career in the company. Before taking up leadership position, she has been associated with the company in various roles and has a performance track

[44]*Ms. ChandaKochhar – ICICI Bank – About Us – Director's Profile*,Accessed from http://www.icicibank.com/aboutus/board-of-directors-chanda-kochhar.html, last visited March 2013.

record. This also indicates grooming of potential successor for the leadership role.

There is no publicly available data to indicate objective assessment parameters for assessing candidates for the leadership role fit. However, the chosen successor appears to have been assessed through various roles within the organization and her performance in those roles of responsibility.

The leadership succession at ICICI Bank Ltd. was a planned succession with the incumbent leader scheduled to retire.

The incumbent leader has continued his association with the company in the chairman's position in a non-executive capacity. This indicates guiding and mentoring of the new leader. However, with ICICI Bank being a professionally-managed company, his involvement in the operations would be minimal.

The successor has continued the growth and performance of ICICI Bank Ltd. as can be seen from the financial statements in the annual reports.

CASE STUDY 3: TATA CONSULTANCY SERVICES [TCS] LTD.

Corporate Profile

Tata Consultancy Services is an IT services, business solutions and outsourcing organization offering services in the areas of application development and maintenance; business intelligence; enterprise solutions; assurance services; engineering and industrial services; information technology (IT) infrastructure services; business process outsourcing; consulting and asset leveraged solutions to various industrial sectors, including banking; financial services and insurance; retail and consumer packaged goods; telecom, media and information services; hightech manufacturing; life sciences and healthcare;

energy, resources and utilities; and travel, transportation and hospitality.[45] Newer services include mobility, connected marketing, social computing, big data and cloud.[46]

TCS is part of the Tata group, one of India's largest industrial conglomerates and most respected brands. TCS was established in 1968 as a division of Tata Sons Limited to service their electronic data processing (EDP) requirements and provide management consulting services. In the year 1971, they started their first international assignment. The company pioneered the global delivery model for IT services with their first offshore client in 1974. In the year 1981, the company set up India's first IT R&D division, the Tata Research Design and Development Centre at Pune. In the year 1985, they set up their first client-dedicated offshore development center for Compaq (then Tandem).[47]TCS Ltd. got incorporated as a separate entity on January 19, 1995.[48] In August 9, 2004, the company became a publicly listed company.[49]

Tata Consultancy Services is currently the largest IT services firm in Asia with revenue of $11.568 billion and net profit of $2.561 billion in 2012-13. TCS had a total of 274,583 employees in 44 countries as of 31 October 2012. TCS is one of the largest private sector employers in India, and the second-largest employer among listed Indian companies.[50]TCS is headquartered in Mumbai. They have 142 offices in 42 countries as well as 105 delivery centers in

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[45]*Company Profile for Tata Consultancy Services Ltd. – Reuters India*,Accessed from http://in.reuters.com/finance/stocks/companyProfile?symbol=TCS.BO, last visited March 2013.

[46]*TCS: About Us: Corporate Facts*,Accessed from http://www.tcs.com/about/corp_facts/Pages/default.aspx, last visited February 2013.

[47]*Tata Consultancy Services Ltd. Background Company profile – IndiaInfoline.com*,Accessed from http://www.indiainfoline.com/Markets/Company/Background/Company-Profile/Tata-Consultancy-Services-Ltd/532540, last visited February 2013.

[48] *Supra note*. 44.

[49] *Supra note*. 45.

[50] *Supra note*. 44.

20 countries. The company shares are listed on the NSE and BSE.[51]

Leadership and Succession

The succession for the managing director and CEO's office was in October 2009.[52]

The incumbent managing director and CEO prior to succession, S Ramadorai has been associated with Tata Consultancy Services Ltd. for the past 39 years. He joined Tata Consultancy Services in February 23, 1972 as a trainee engineer.[53] He took over as CEO in 1996 when the company's revenue was $160 million and has since then led the company through some of its most exciting phases, including its going public in 2004.[54]

Ramadorai's academic credentials include a bachelors degree in physics from Delhi University (India), a bachelor of engineering degree in electronics and telecommunications from the Indian Institute of Science, Bangalore (India), and a masters degree in computer science from the University of California - UCLA (USA). In 1993, Ramadorai attended the Sloan School of Management's highly acclaimed "Senior Executive Development Program."[55] He received Padma Bhushan in January 2006 for his commitment and dedication to IT industry.[56]

He retired as managing director & CEO in October 2009, and took up his present position as non-executive vice-chairman of the board of directors

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[51] *Supra note*. 44.

[52] *TCS: Board of Directors* (Accessed from http://www.tcs.com/about/corp_facts/board_directors/Pages/default.aspx#ramadorai)

[53] *Subramaniam Ramadorai: Executive Profile & Biography –Businessweek,* Accessed from http://investing.businessweek.com/research/stocks/people/person.asp?personId=6411820&ticker=6411769, last visited March 2013.

[54] *Ibid.*

[55] *Ibid.*

[56] *Ibid.*

of Tata Consultancy Services Ltd.[57]

The successor, N Chandrasekaran joined the company in 1987 after completing his masters in computer applications from Regional Engineering College, Trichy, Tamil Nadu in 1986. He also holds a bachelor of science in applied science from the Coimbatore Institute of Technology, Tamil Nadu. Responsible for formulating and executing the company's global strategy; Chandra has been at helm of several key strategic transitions at TCS since 2002 when he took over the role as head of global sales. In his previous role as Chief Operating Officer, he was the architect of the new organization structure unveiled in 2008, which created multiple agile business units focusing on domains and markets as well as built strategic business units in order to pursue new initiatives with the ability to invest, develop and mature new ideas.[58]

Through his experience in a variety of operating roles, he has built a reputation in the IT industry for his exceptional ability to build and grow new business offerings and nurture long-term relationships. His responsibilities included global delivery, sales in North America, the United Kingdom, EMEA, Iberoamerica and India, quality, service offerings, business process outsourcing, technology alliances and information systems. He also managed corporate responsibility in the marketplace, specifically for customer relationships. He served as the global operations director, executive vice president, and head of Europe operations of Tata Consultancy Services Limited. He served as the global head of sales and operations of TCS.[59] Chandra has led TCS to great

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[57]*Ibid.*

[58]*Interview of N Chandrasekaran, CEO and MD, Tata Consultancy Services - IndiaInfoline.com*,Accessed from http://www.indiainfoline.com/Research/LeaderSpeak/N-Chandrasekaran-CEO-and-MD-Tata-Consultancy-Services/42446866, last visited March 2013.

[59]*Natarajan Chandrasekaran: Executive Profile & Biography Businessweek*,Accessed from http://investing.businessweek.com/research/stocks/people/person.asp?personId=24403000&ticker=6411769' last visited March 2013.

success with the market capitalization of the company touching USD 50 billion during 2012. TCS was consistently ranked throughout 2012 as the most valuable company in India.[60]

Succession Analysis

Tata Consultancy Services Ltd., being a part of the Tata Conglomerate, is a family-owned or family-controlled company but has been professionally-managed throughout its history. The leaders typically have had long tenures at the helm.

The publicly available data in the form of annual reports does not indicate the presence of a systematic succession strategy being in place at Tata Consultancy Services Ltd.

The successor comes from the ranks of the organization and has had a long career in the company. Before taking up leadership position, he has been associated with the company in various roles and has a strong performance track record. This also indicates grooming of potential successor for the leadership role.

There is no publicly available data to indicate objective assessment parameters for assessing candidates for the leadership role fit. However, the chosen successor appears to have been assessed through various roles within the organization and his performance in those roles of responsibility.

The leadership succession at Tata Consultancy Services Ltd. was a planned succession with the incumbent leader scheduled to retire.

The incumbent leader has continued his association with the company in the vice-chairman's position in a non-executive capacity. This indicates guiding

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[60] *TCS: Leadership team*, Accessed from http://www.tcs.com/about/corp_facts/leadership_team/Pages/default.aspx#chandrasekaran, last visited March 2013.

and mentoring of the new leader. As Tata Consultancy Services Ltd. is a professionally-managed company, his involvement in the operations would be minimal.

Tata Consultancy Services Ltd. has continued its growth rate and leadership position under Chandra's leadership. The company has been announcing strong financial results and has been successful in performing above industry average. Employee additions, client additions, new locations as well as inorganic growth through acquisitions, all show strong performance.

FINDINGS OF CASE STUDIES

The study has analyzed three companies wherein one is family-owned and family controlled, one is professionally-managed while the third although family-controlled, is professionally managed.

On the *parameter of systematic succession strategy*, there was no data available to indicate either presence or absence of succession planning. This may be due to confidential nature of such plans.

On the *parameter of origin of the successor*, the study indicates that all three companies chose insiders for the leadership role. While ICICI Bank and Tata Consultancy Services Ltd. chose professional successors from the organizational ranks, Bajaj Auto inculcated the potential leader in the ranks before being given the leadership role.

On the *parameter of assessment of potential successors*, the companies show a preference for demonstrated performance through various roles and responsibilities over a long time period.

On the *parameter of conditions under which succession took place*, all three case studies covered companies where the succession was imminent due to the scheduled retirement of the incumbent leader.

In all three case studies, we see the incumbent leader continuing in a mentoring role. There is no data available publicly to indicate the exact role played by the incumbent or Independent directors in the succession process.

Under the leadership on new successor leaders, all three companies have shown strong growth on financial as well as non-financial parameters.

REMARK AND RECOMMENDATIONS

In India, SEBI is charged with the duty of enforcing corporate governance in its role as the market regulator. SEBI achieves this goal though a market mechanism in the form of Clause 49 of the listing agreement that every public-listed company has to sign with the stock exchanges. It is recommended that a new provision be added to the said clause 49 to address "Leadership Succession" in the form of a "Succession Management Committee" through suitable amendment made to the listing agreement.[61]

The board of directors of every public-listed company shall set up a "Succession Management Committee," subject to the following:

A. The committee shall be charged with preparing and maintaining the leadership succession plan. The succession plan for each company is unique to its needs and highly confidential. Its disclosure can result in adverse reaction from the stock markets, possible demoralizing effect in the ranks of the organization and unwarranted scrutiny at critical junctures. Therefore, the details of such plans need not be disclosed in depth.

B. The committee shall be charged with supervising "Management Leadership Development Program," including identifying potential leadership

[61] See, Para 11.16, SEBI Consultative Paper on Review of Consultative Paper on Review of Corporate Governance Norms in India,available at, http://www.sebi.gov.in/cms/sebi_data/attachdocs/1357290354602.pdf,Last visited,23 October 2013.

candidates within the ranks of the organization and grooming them as appropriate with a long term perspective.

C. The committee shall report its activities through the corporate governance report included within the annual report of the company. As discussed above, details of leadership succession plan may be confidential. However, the committee shall report the preparation and maintenance of the succession plan and its objectives as well as progress of leadership development activities.

D. The committee shall have minimum three directors as members, with two-thirds of the members being independent directors. Further, the committee shall have at least one member with human resource management expertise.

E. The committee may be non-mandatory, and further, Clause I.D(iii) may be added to Clause 49 of the Listing Agreement requiring disclosure of the discussions pertaining to succession undertaken by the Committee.

NEED TO SEE FURTHER

A number of topics that are incidental to this study are worth exploring in future. These areas were excluded from the current study in order to limit the scope to a manageable scale as well as to examine a consistent scenario. However, they are worth exploring in more detail.

Sudden or unanticipated Leadership Succession

The present study focused on anticipated succession, wherein it was well-known that the incumbent leader was about to retire. What happens when there is a scenario of death of the incumbent leader or an unplanned resignation or a situation where the board is forced to remove the leader in emergency? McDonalds' CEO Jim Cantalupo died suddenly in April 2004 at a

convention, but thanks to his vision of grooming a successor, the Board appointed a new CEO within six hours.[62] On the other hand, the unexpected death of Aditya Birla at the age of 52 in 1995 left his business group in the hands of his 28-year-old son Kumar Mangalam Birla with doubts about is future. After DhirubhaiAmbani passed away in July 2002, Reliance Industries Empire was embroiled in a bitter succession battle despite both his sons being groomed for leadership. How are such unanticipated leadership changes to be managed? How can corporate governance principles be applied to such situations for efficient contingency planning? These questions can be taken up under this topic.

Succession planning as an ongoing process

The present study looked at specific cases of leadership succession. However, a broader theme of ongoing multi-generational leadership succession planning and grooming of potential candidates to take up the top leadership roles warrants a detailed study as such an ongoing process is in line with the principles of corporate governance. A notable example is the TAS program at the Tata Group conceived by JRD Tata for grooming future leaders.[63]

Objective Parameters for Successor Candidate Selection and Actual Process of Succession

While this study focused on leadership succession on a holistic level, it is also interesting to explore the set of objective parameters or criteria that the board

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[62]William Rothwell: *Effective Succession Planning: Ensuring Leadership Continuity and Building Talent from Within*, AMACOM, 3rd Edition, (2005), pp.14.

[63] See http://www.tas-tata.com/ and http://www.tata.in/careers/articles/inside.aspx?artid=teU3Hb/7cYo=, last visited March 2013.

can use to evaluate potential candidates. What decision making methods can be applied to select such criteria and what are some of the best practices in this regard across the world is a topic worth researching. Further, such a study can analyze the actual process of succession starting with the formulation of the set of objective parameters and touching upon candidate selection and the process of transition in depth.

Leadership Succession in Private Companies

This study focused on public-listed companies in its scope. However, in the course of this study, a need was felt to analyze leadership succession issues in privately owned, unlisted companies. Despite fewer legal and regulatory obligations on disclosures and corporate governance, how can the principles of corporate governance as they apply to leadership succession, be employed in private companies and what is the scenario at present is a topic of a future study.

Leadership Succession in family-controlled companies

Succession planning in family businesses is a specialized topic. In Europe or Asia, many large companies are essentially family dynasties.[64] Family-owned or family-controlled companies are a significant form of business organization in India. Such enterprises are of all sizes, small, medium, large and giant, as well as both private and public. An important issue in this context is the interplay of conflict between the incumbent leader's obligations to the company and corporate governance and his obligations towards his family which effectively

[64]Rothwell, William: *Effective Succession Planning: Ensuring Leadership Continuity and Building Talent from Within*, AMACOM, 3rd Edition, (2005) pp.49-52, last visited March 2013.

owns or controls the business.[65] A family-chosen successor may not be the best candidate to run the company. In this context, succession in family-owned or family controlled companies needs to be studied in depth with emphasis on public companies.

Decoupling of Impact of Economy and Market factors from Impact of succession on performance parameters

This paper examines the performance of the successor to assess the effectiveness of the succession. Such performance, depicted via financial results numbers and events, is not a function of the succession alone. More than anything else, economic factors and market factors have a primary impact on performance. Buoyant economy can make an incapable or inefficient leader look great while performance can be severely affect during a recession despite the leader being capable. Therefore, a method of decoupling these factors needs to be explored if the impact of leadership succession alone is to be evaluated.

[65] *Id* at pp.53

GOVERNANCE IN PPP MODEL OF INFRASTRUCTURE PROJECTS IN INDIA: ISSUES AND CHALLENGES

- Dr. Rashmi Nagpal*

ABSTRACT

The growth of Indian economy in a sustained manner is of vital importance for equitable development in the country which can impact all sections of society. The requirement for sustainable infrastructural development is paramount to provide the backbone for economic activities as well to ensure that resources are conserved and used most efficiently. Public private partnerships or PPPs are seen to have a significant role in bringing in much needed investments as well as efficiencies in utilization and management of resources. While private telecom services is a success story in India, the PPP constitutes comparatively a minor share in overall infrastructure building despite initiation of various policy measures and sector-related reform programmes. The promotion of good governance based on certain generally accepted core principles of accountability, transparency, fairness, efficiency, decency and participation, is a major responsibility of the government. Supported by the Asian Development Bank, Government of India, therefore, has been focusing to create the enabling environment targeting on capacity building and institutionalization of PPPs across the country. The legal environment country wide, state specific legislation for infrastructure and PPPs, and, project specific contracts are the most critical aspects which govern attractiveness of infrastructure sectors and projects to the private sector, also government agencies, whether local governments or others, and thus it is important

*LL.B(gold med.),LL.M(gold med.),UGC NET, Ph.D. Visiting faculty Nirma University, Ahmedabad, Ex-Faculty Amity University, Lucknow

that they have sufficient awareness of key legal and contractual issues so that projects are well structured, contracted, implemented and monitored. This paper attempts to discuss legal and governance aspects of PPP Model of Infrastructure Projects and to explore the key elements that need to be present in the institutional environments surrounding the projects, namely clear rationale, political willingness, advocacy, predictability, commitment in decision making and capacity to develop and monitor projects.

INTRODUCTION

For the development of an economy, physical infrastructure is an integral part and provides basic services that people need in their everyday life. The contribution of infrastructure to economic growth and development is well recognized as it has been seen that well developed physical infrastructure provides key economic services efficiently, improves the competitiveness, extends vital support to productive sectors, generates high productivity and supports strong economic growth. To achieve meaningful growth, developing countries have to promote infrastructure development as infrastructure is vital to the nation's economic growth. Infrastructure may be considered to be the skeleton on which the society is built including highways, railways, ports, bridges, hydraulic structures, power plants, tunnels, municipal facilities like sanitation and water supply, and other facilities serving public needs. Adequate funding is required to construct and maintain the requisite infrastructure which has a positive effect in ensuring continuous economic development, apart from meeting basic needs. The immediate need for such projects coupled with chronic budget shortages experienced by public agencies encouraged the use of innovative financing and many countries, particularly, developing countries shortage of public funds have led governments to invite private sector entities

to enter into long term contractual agreements for financing, construction and operation of capital intensive infrastructure projects. Physical infrastructure covering transportation, power and telecommunication through its forward and backward linkages facilitates growth; social infrastructure including water supply, sanitation, sewage disposal, education and health, which are in the nature of primary services, has a direct impact on the quality of life.

However, in proceeding towards this goal, developing countries face various constraints, among which, lack of advanced technology and inadequate public financial resources are two major drawbacks. To overcome or alleviate these constraints, developing countries are encouraging local and foreign private sector involvement in the provision of infrastructure projects or services. Global trends of privatization and reduced governmental roles extend to developed countries as well. Models of private sector involvement are1:

Full Private Provision or FPP: In this case, the government allows complete ownership of the asset to private players. The government assumes no responsibility or risk. e.g., Hyderabad Metro and telecom.

PPP schemes: In the case of PPPs, the investment is funded and operated through a partnership between the government and one or more private sector players. e.g., Delhi and Mumbai Airports.

Private Finance Initiative or PFI: These schemes introduce the benefits

[1] *A guide book on public private partnership in infrastructure-United Nations Economic and Social Commission for Asia and the Pacific, January,2011*, at http://www.unescap.org/ttdw/common/TPT/PPP/text/ppp_guidebook.pdf, visited on Sepember5,2013

of private sector management and finance into public sector projects and differs from privatisation since the responsibility of providing essential services to the public is not transferred to the private sector; nor is the asset-ownership transferred, e.g., in solid waste management, electricity distribution franchising and so on.

Today, in India, PPP is generally used to broadly connote all these models of private sector involvement in the infrastructure arena and is holistically termed as PSP or "private sector participation".

Basic Characteristics of a PPP arrangement

Infrastructure projects have long gestation period, are capital intensive, involve multiple risk to the project participants and are therefore complex. These are characterized by non-recourse or limited-recourse financing where lenders are repaid from only the revenues generated by projects. Even though PPPs have a long history in many countries, a clear and comprehensive rule covering the use of PPPs is deficient in both international and domestic levels. The partners in a PPP usually through a legally binding contract or some other mechanism agree to share responsibilities related to implementation or operation and management of an infrastructure project. This collaboration or partnership is built on the expertise of each partner that meets clearly defined public needs through the appropriate allocation of: resources, risks, responsibilities and rewards.2 These projects have a capital cost during construction and a low operating cost afterwards which implies that the initial

[2] *Adapted from the definition of PPP provided by the Canadian Council for PPPs,* at http;//www. ppp concil.ca/about PPP_definition.asp, visited on September5,2013

financing costs are very large compared to the total cost. Further, a mix of financial and contractual arrangements amongst the multiple parties including the commercial banks, project sponsorers, domestic and international financial institutions and government agencies makes it further complex.

The Government seeks to utilize private sector finance in the provision of public sector infrastructure and services and thereby achieve value for money. Value for money, defined as the effective use of public funds on capital project, can come from private sector innovation and skills in asset design, construction techniques and operational practices. It may also come from transferring key risks in design, construction delays, cost overruns and finance to private sector entities. However, in some cases, the emphasis on risk transfer can be misleading as value for money requires equitable allocation of risk between the public and private sector.

What is Public-Private Partnership?

The expression public-private partnership is a widely used concept world over but there is no broad consensus on what constitutes a PPP. Broadly, PPP refers to arrangements, typically medium to long term, between the public and private sectors whereby some of the services that fall under the responsibilities of the public sector are provided by private sector, with clear agreement on shared objectives for delivery of public infrastructure and/ or public services. In order to achieve partnership, a careful analysis of the long term development objectives and risk allocation is essential. In addition, legal framework must adequately support this new model of service delivery and should be able to monitor and regulate the outputs and services provided. The

Planning Commission of India has defined the PPP in a generic term as "the PPP is a mode of implementing government programmes/schemes in partnership with the private sector. It provides an opportunity for private sector participation in financing, designing, construction, operation and maintenance of public sector programme and projects"3. In addition, greenfield investment4 in the infrastructure development has also been given more encouragement in India.

The PPP is also defined as "the transfer of investment projects that traditionally have been executed or financed by the public sector to the private sector, any arrangement made between a state authority and a private partner to perform functions within the mandate of the state authority, and involves different combinations of design, construction, operations and finance is termed as PPP model."5

PPP offers monetary and non-monetary advantages for the public sector. It addresses the limited funding resources for local infrastructure or development projects of the public sector thereby allowing the allocation of public funds for other local priorities. It is a mechanism to distribute project risks to both public and private sector. PPP is geared for both sectors to gain improved efficiency and project implementation processes in delivering services to the public. Most importantly, PPP emphasizes value for money thereby focusing on reduced costs, better risk allocation, faster implementation,

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[3] *Towards Faster and More Inclusive Growth: An Approach to the 11th Five Year Plan*, Planning Commission, New Delhi, November 2006.

[4] Greenfield investment is defined as an investment in a start-up project, usually for a major capital investment and the investment starts with a bare site in a greenfield.

[5] *PPP In Infrastructure Resource Center,* at http://ppp.worldbank.org/public-private-partnership/overview,visited on September4, 2013

improved services and possible generation of additional revenue.

A number of OECD countries have well established PPP programmes. Countries with significant PPP programmes include Australia and Ireland while US has considerable experience with leasing. Many continental EU countries, including Finland, Germany, Greece, Italy, the Netherlands, Portugal and Spain have PPP projects, although their share in public investment remains modest. Reflecting a need for infrastructure investment on a large scale, and weak fiscal positions, a number of countries in Central and Eastern Europe, including the Czech Republic, Hungary and Poland, have embarked on PPP. There are also PPP programmes in Canada and Japan. The PPP in most of these countries are dominated by road projects. Similarly, the EU Growth Initiative envisages the use of PPP type arrangements primarily to develop trans-European road network.6

In UK's Private Finance Initiative (PFI), a form of PPP program, the public sector purchases services from the private sector under long-term contracts However, there are other forms of PPP used in the UK, including where the private sector is introduced as a strategic partner into a state-owned business that provides a public service.

The PPP is sometimes referred to as a joint venture in which a government service or private business venture is funded and operated through a partnership of government and one or more private sector companies. Typically, a private sector consortium forms a special company called a Public-

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[6] *Reserve Bank of India Occasional Papers Vol. 29, No. 1, Summer 2008,Public-Private Partnership in Indian Infrastructure Development: Issues and Options.*

Private Partnerships (PPP's or P3's) which is becoming a common tool to bring together the strengths of both sectors. In addition to maximizing efficiencies and innovations of private enterprise, PPPs can provide needed capital to finance government programs and projects, thereby freeing public funds for core economic and social programs. Public Private Partnerships (PPPs) present the most suitable option of meeting targets, not only in attracting private capital in creation of infrastructure but also in enhancing the standards of delivery of services through greater efficiency.

India, the leading destination:

The share of PPP in infrastructure sector was 24.5 per cent during 2002-2007, increased to 36 per cent during 2007-2012. This is expected to go up to 50 percent by 2017.

India has had the most success, attracting more private investment in infrastructure in 2006 than any other developing country. But at the same time progress has been uneven, with some states having undertaken far more PPPs than others and in some sectors there is a much heavier use of PPPs as compared to others. In terms of frameworks for PPPs, some states have made more attempts to develop this, including development of cross sectoral units that play a vital role in the identification and preparation of PPPs.

PPP in social and education sector: Public-private partnerships can revolutionise education in India and facilitate growth to help prevent millions of children missing out on quality education. They can raise the standards of education provision in India and help meet the demand for quality education

from a growing middle class with increasing incomes. There is a need to focus on public-private partnership (PPP) in social sector too such as health and education. Some State governments have already taken steps in this regard, the emergency medical response service popularly known as '108 service' in Karnataka and Gujarat is a good example in this regard. An ambulance rushes to help those in need when a call is made to the toll-free number 108.[7]

Legal and Regulatory Framework

The PPP story began with private sterling investments in Indian railroads in the latter half of the 1800s. By 1875, about £95 million was invested by British companies in Indian "guaranteed" railways. Or we could trace it to the early 1900s, when private producers and distributors of power emerged in Kolkata (Calcutta Electric Supply Corporation) and Mumbai, with the Tatas playing a prominent role in starting the Tata Hydroelectric Power Supply Company in 1911.Cut to the early 1990s, and one could postulate that it was then that the new-wave PPP movement started. A policy of opening electricity generation to private participation was announced by the central government in 1991, which set up the structure of independent power producers, or IPPs. The National Highways Act, 1956, was amended in 1995 to encourage private participation. In 1994, through a competitive bidding process, licenses were granted to eight cellular mobile telephone service operators in four metro cities and 14 operators in 18 state circles. But a date that would capture the essence of a clear historic shift, one could zero in on January 30, 1997, when the

[7]Editorial, Public-private partnership essential in social sector, *Business Line*, March 22, 2013

Infrastructure Development Finance Company was incorporated in Chennai under the initiative of the then Finance Minister P Chidambaram. The firm, promoted by the government of India, was set up on the recommendations of the "Expert Group on Commercialisation of Infrastructure Projects" under the chairmanship of Rakesh Mohan and Deepak Parekh was chosen as the first chairman. The purpose was that this would signal the government's seriousness in channeling private sector capital, expertise and management thereby giving boost to nation's infra development8.

Efforts have been made to create the right enabling environment for the PPP story to unfold rapidly. These relate to enacting legislation for example, the Electricity Act, 2003; the amended National Highways Authority of India Act, 1995; the Special Economic Zone Act, 2005; and the Land Acquisition Bill. As also the creation of new institutions like regulatory authorities in telecom, power, roads and airports, implementing authorities like the National Highways Authority of India (NHAI), and financial institutions like the Infrastructure Development Finance Company, the India Infrastructure Finance Company and so on. A slew of model concession agreements across sectors created the template for private participation. Innovative financial interventions like viability gap funding, annuity models and stimulation of debt for infra have also added fiscal punch. The Planning Commission, the Department of Economic Affairs in the Ministry of Finance and the Prime Minister's Office have all played a stellar role in "making PPP happen". Many states, too notably Punjab, Gujarat, Maharashtra, Delhi, Karnataka and TamilNadu have built significant capacity to

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[8] Available at http://www.business-standard.com/article/opinion/vinayak-chatterjee-ppp-in-india-the-story-so-far, visited on August28,,2013

deliver on PPP.[9] Government of India has introduced several innovative Schemes aimed at promoting PPPs. to attract the private sector, commercially viable projects should be on offer and to inculcate the discipline of 'user pay principle' and provision of these services should be based on payment of tariff, Government must also fulfill its commitment towards inclusive growth which makes it obligatory to fix the tariffs based on the capacity of the common man to pay. Due diligence is also essential given the substantial contingent liability that could devolve on the State in such projects. Had someone in the late eighties asked about the future role of private capital and enterprise in Indian, when the state ran close to 100 per cent of public utilities, he would have received a look of bemused incredulity at such a possibility. In fact, India is today easily the world's largest PPP market.

Issues and concerns:

Despite improvements in physical infrastructure development in the country during the recent years, significant gap exists between demand and supply of critical infrastructure facilities, which has become a binding constraint on the rapid pace of economic progress.

In the case of power sector, the power shortage during the peak demand period has been much higher, which severely affects the industrial production and economic development. Employee productivity of railways in India is very low when compared to China, Korea, Brazil and Indonesia. Wagon shortage hinder the movement of industrial raw materials, coal, minerals, etc., which affects the industrial production. Port container and air freight traffic is also very

[9] *Supra* note 2

low in India as compared to other Asian economies. India's weak export infrastructure in the ports, congestion problem and insufficient bulk terminals are major constraints in this sector. Space is a major constraint in big cities to expand the basic infrastructure. The absence of well defined law to acquire land for public infrastructure development has also lead to slowdown in the urban infrastructure. Poor basic amenities in the rural areas are also a major concern, despite 72 per cent of the population living in villages.10

The UN Office on Drugs and Crime (UNODC) has also flagged loopholes in Indian laws' ability to curb such graft, and suggested that private partners in PPPs be designated as public officials to make them accountable under the Right to Information Act. This would not only bring such projects under the proposed laws but also protect whistleblowers and guarantee service delivery to citizens.11

When we look at the progress of infrastructure development so far, private participation and PPP arrangements in the development of public infrastructure have still faced several implementation challenges. These challenges typically involve tariff setting and adjustment, regulatory independence or dispute over contractual provision and risk sharing. It may be observed from the discussion so far, the PPP in the infrastructure development is picking up during the recent years, particularly in the road sector and to some extent in the airports and ports sectors. Telecom sector is considered to be a

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[10] Stephen Harris, *Public Private Partnership: Delivering Better Infrastructure Services, Working Paper,* Inter-American Development Bank, at http://www.alide.org/Data Bank2007/RecInformation/2APP Infrastruture.pdf , visited on Septemaber 5, 2013

[11] Editorial, PPP Infrastructure and power projects most prone to corruption: UN Body, *The Economic Times*, June 3, 2013

successful sector in attracting private participation on a large scale. This may be due to sector-specific policies and other factors such as Government commitment, increased private interest in these sectors, move towards better competitive process, greater availability of information, size of the projects, acceptable price and encouraging developer return, fiscal concessions, etc. However, considering the size and magnitude of the proposed and ongoing projects in the infrastructure sector as a whole, the lackluster response by the private participation and slow progress in some of the projects need to be reversed through investor friendly policies, transparent procedures and other conducive measures. The PPP model will not be feasible in all types of infrastructure but they are possible in many areas, which are to be exploited fully. The key to making PPP model acceptable is to create an environment where PPPs are seen to be a way of attracting private money into public projects, not putting public resources into private projects.12 Towards this direction, the following measures need the attention of all concerned, to make not only the PPP model a success, but also to attract more private participation to upgrade the Indian infrastructure into a world-class.

.Increasing transparency of the bidding-out process: Even as India still has a long way to go on the Transparency International list, it is indeed heartening to see that there has been a sharp fall in "crony capitalism" in the award of PPP projects. Recent times have seen practically no complaints from the slew of NHAI projects bid out. Power bids have been ferociously fought. And airport bids were examples in ultimate transparency. Even as a lot of governance issues still remain in execution and implementation, few will

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[12] *Supra* note 5

disagree that the average newspaper reader can easily discover the bid-criteria point at which a private player has been selected. E-auctions are adding to this credibility. The scams in telecom and other sectors have lead to “transparency alertness” in the media, the judiciary, civil society, and investigative and audit institutions.13 The PPPs can run into controversy if the private partner is seen to have received unduly favourable treatment. This can be overcome by ensuring that the terms of concession agreements are transparent and protective of public interest.

Risk allocation and management: Since the projects in the infrastructure sector requires huge investments and involve much time frame for their execution, various risks, viz., construction risk, financial risk, market risk, performance risk, demand risk and residual value risk are to be allocated appropriately among the constituents. The risks should not be passed on to on to others as and when arise, which would affect the cost and progress of the project and create unnecessary litigations. Too many risks assumed by Government will likely put unjustified pressures on taxpayers. On the other hand, too few will prevent potential private investors from participating in the venture.

Project Implementation criteria: Execution of infrastructure projects should have a clear choice about its implementation whether by the Government or private or both under PPP. Also, the technicality of the project should be clear regarding its soundness, viability and return. When we look at

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[13] David W. Gaffey, Outsourcing Infrastructure: Expanding the Use of Public-Private Partnerships ,*Public Contract Law Journal*, Vol. 39 Issue 2, 351(2010)

the PPP programme, while there are a number of successful projects, there have also been a number of poorly conceptualized PPPs brought to the market that stood little chance of reaching financial closure. Clear appraisal of the project before its execution would avoid many litigations. At the same time, it is important to avoid a possible bias in favour of the private sector.

Regulatory Independence: Though regulatory independence is vital for speedy implementation of policies, there are instances of disagreements between the regulatory authorities. To reduce the risk of arbitrary and ad-hoc policy interventions due to disagreement between the authorities, principles on key issues need to be specified upfront in sufficient detail.14

In the infrastructure sector, regulatory bodies like Telecom Regulatory Authority of India, Central Electricity Regulatory Commission, State Electricity Regulatory Commissions, Tariff Authority of Major Ports, National Highway Authority of India and Airport Authority of India have been established as autonomous agencies to regulate the activities coming under their jurisdiction.

Centre-State Disagreement: Execution of some of the projects like airport development, road, etc., are delayed due to disagreement between the Centre and the State Governments in various aspects, particularly location choice, cost sharing structure, political disagreement, etc., which need to be avoided with appropriate policies, political will, cooperation, coordination, dedication and determination.

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[14] *India: Building Capacities for Public Private Partnerships, Energy and Infrastructure Unit and Finance and Private Sector Development Unit*. South Asia Region, June 2006.

Managing Cost, Time and ensuring government guarantee: Many of the projects under the PPP are delayed due to litigations, which lead to cost and time overruns in their implementation: Generally, investors look for Government guarantee for their investments and their return before entering into a venture. Constant changes in the procedures for offering Government guarantees discourage the investment opportunities. Though, Government guarantee for private investment is not a preferred option in the fiscal angle, transparent policies and guidelines towards Government guarantee will provide clear perception and encouragement towards the PPP even in the risky areas of investment.15

Good Governance: Most important of all, Good corporate governance will succeed in attracting a better deal of public interest because of its apparent importance for the economic health of corporates and society in general. The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters. The corporate governance practices of the parties involving in the PPP have to match with the benchmarking corporate governance practices with the best in the rest of the world.

Responsibilities of and Liabilities on the Govt.:

Each country has its own unique approach towards soliciting and evaluating PPP project proposals. Many countries have special legal instruments concerning PPPs. In India, infrastructure gaps exist in almost all the sectors, posing a serious threat to sustenance of the growth momentum. To augment the infrastructure facilities with private participation, the initiated policy

[15] Devarajan and Harris, Does India have an infrastructure deficit, *The India Economy Review* at http://pppinindia.com/pdf/gridlines.pdf, visited on September 4, 2013

measures have not met with significant success. Except for the telecom sector, which has witnessed a revolution and has been able to attract massive private investments, other sectors have faced with lacklustre response. Even in the telecom sector, though the overall tele-density has improved during the recent period, rural tele-density remains low, which needs to be dealt with appropriate policy measures. The status of the PPP in the infrastructure development in India, both in the Central Government schemes as well as State sponsored schemes, is not encouraging. Stable macroeconomic framework, sound regulatory structure, investor friendly policies, sustainable project revenues, transparency and consistency of policies, effective regulation and liberalisation of labour laws, and good corporate governance are the basic requirements, which define the success of the PPP model. The PPP model in the road sector has experienced with enthusiastic response. However, many of the road projects are faced with cost and time overruns on account of prolonging disputes in land acquisition, hurdles in the material movements, law and orders problems, etc. Efficiency in cargo handling needs to be enhanced through modernisation of port facilities to facilitate the trade. The PPP model projects in the airport sector are in slow progress and also restricted to major airports. Modernisation of some of the airports is yet to take-off due to procedural hassles and land acquisition problems. This brings to the fore a need for constructive and stable policy environment towards land acquisition for public utilities. The urban infrastructure bottlenecks need to be addressed through a development strategy, which encompasses efficient planning and organisation of the project, balancing the public-private interest, reinvigoration of electricity, water supply and transportation system and integration of finance and technology.16

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[16] *Towards Faster and More Inclusive Growth*. An Approach to the 11th Five Year Plan, Planning Commission, New

International experience suggests that the success of PPP projects requires a single objective of better services for the public at a reasonable cost. This is achievable through realistic and reasonable risk transfer while addressing the public concerns. The Indian PPP model should adhere to such objectives and best practices to march forward on the success path. In this pursuit, easy availability of long-term private capital is an essential requirement. Fostering the Greenfield investments in the public infrastructure with appropriate user charges, transparent revenue and risk sharing agreements would transform the international capital inflows into productive ventures. Above all, selection of right PPP model for a right project at a right time through realistic planning would go a long way in providing meaningful and hassle free infrastructure development, which ultimately would increase the infrastructure standards and thereby sustain the overall macroeconomic developments of the country. In addition, appropriate institutional framework is a prerequisite for the success of the PPP in the infrastructure development due to its size, investment requirements, structure and dimension. Foreign investment will freely flow into a country when there is sound, stable and predictable investment policy. Frequent changes in the policies will be an irritant to the investors, which is to be restricted in an emerging economy like India. Overall, in addition to sector-specific issues, the generic issues also need the attention of all concerned to make not only the PPP model a successful but also to attract more private participation to upgrade the Indian infrastructure into a world-class. The need for Public Private Partnership in the Indian infrastructure sector has been well recognized by the Government of India at the India Infrastructure Summit

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Delhi, November 2006.

2012, and the steps taken to encourage Public Private Partnerships are promising. Such steps include17:

- Creating the India Infrastructure Development Fund;
- Establishing Institutional Mechanism like the Indian Infrastructure Finance Company Limited to facilitate infrastructure development and PPP;
- Standardising contractual documents as sector specific Model Contracts;
- Concession Agreements;
- Standardising Bidding Documents;
- Relaxing the restrictions on foreign direct investment in most infrastructure sectors; and
- Fiscal Incentives including the Income Tax Act, 1961 and state laws to developers and lenders of Infrastructure Projects.

Such steps are particularly relevant in the context of India's estimated investment need in the infrastructure sector. To the uninitiated the governing frameworks of the various infrastructure sectors might appear to be maze of, institutional structures, arrangements rights, obligations and duties. However, when we look beyond the formal structures a crucial point of note is that parties (both private and public) are free to enter into valid and enforceable commercial arrangements so long as their business arrangements are compliant with the rules of entry (for example those regarding foreign direct investment) and the rules of the game for doing business in the industry concerned. Such commercial arrangements include:

- Providing suitable incentives for commercial activities and economic enterprise that best serve the national interest;

[17] *Supra* note 15

- Providing a facilitative business environment for stakeholders to transact business, with suitable risk- allocation and safeguards;
- Safeguarding scarce resources and strategic national interests; and enable the 'welfare objectives' of the state and 'economic objectives' of private entrepreneurs to be successfully integrated.
- Arrangements for partnering or collaboration in ventures between two or more persons including incorporation of specific entities with the rules for their functioning;
- Contracts for all or any of the following components/elements such as, sale or supply of goods, services or intellectual property rights-including business process, outsourcing (BPO),Engineering
- Procurement and construction (EPC), operations and maintenance, refurbishment and modernisation, Contracts permitting the use of certain assets, facilities and rights like leases, licences, concessions; and contracts for financing arrangements which could vary in complexity and sophistication from a sale and purchase of milk or a newspaper every morning to a thirty year power purchase agreement or concession to build, operate and transfer an airport.

The legal regulatory-policy framework for PPPs should be:

- The framework should not be prescriptive or rigid but ought to be flexible to accommodate diverse formats of PPP-as per the needs of the sector as also peculiarities or specifics of any project.
- The framework must provide for striking a sustainable balance between universal service or life-line supply, and commercial viability of the sector.

- These projects are characterized by their being inclusive for poorer sections of the community with large clusters of low income families and illegal connections. They have been successful in providing affordable and reliable supply through greater degree of community participation like the local residents' welfare associations, resulting insignificant efficiency gains and bolstering viability of the project.

In addition to governance and due diligence functions, the institutional framework nurtures and encourages new models and innovation and develops capacities to successfully discharge changing roles and responsibilities that PPPs require. The Government has supported the creation of nodal agencies such as the PPP Cells at a State or sector level.18 Recognising that strengthening the capacities of different levels of government to conceptualize, structure and manage PPPs will lead to more and better PPPs, for that Department of Economic Affairs is facilitating mainstreaming Public Private Partnerships through Technical Assistance from Asian Development Bank (ADB). The primary objective is effective institutionalization of the PPP cells to deliver their mandate through provision of 'in-house' consultancy services to each of the selected entities at the Center and State level which helps in refining the PPP policy and regulatory framework. Under Strategy 2020, ADB will expand work with the private sector to generate greater economic growth in the region. Public private partnership (PPP) is seen as an important modality to achieve this objective, and Strategy 2020 emphasizes the promotion of PPPs in all of ADB's

[18] *Institutional & Governance Mechanism,* at http://www.pppinindia.com/Institutional-&-Governance-Mechanism.php, visited on September 4,2013

core operations.[19]

CONCLUSION:

Public-private partnership has played a significant role to boost the undergoing processes of national economic growth, targeting towards financing, designing, implementing and operating infrastructure facilities and public services such as health, utilities, education, and sanitation, etc that were traditionally provided by the public sector. The government of India is leading the process of promoting PPP projects in India to create a success story. However, the overall financing gaps in infrastructure are quite high as per the estimates of planning commission of India. The investment needs for infrastructure is enormous. India faces a very large financing gap which needs to be bridged by domestic as well as foreign and private sector investment. Stable macroeconomic framework, sound regulatory structure, investor friendly policies, sustainable project revenues, transparency and consistency of policies, effective regulation and liberalisation of labour laws, and good corporate governance are the basic requirements, which define the success of the PPP model. Expanding the use of PPP would enable the government to provide needed public infrastructure while minimizing both short and long-term expenditures, and also to capitalize on the private sector's management skills, expertise, experiences, innovation, and alternative methods of funding. This can also have a significant impact on international commerce, especially as in an era of rising national debt and budget deficits. In the context of the global financial turmoil we are facing, PPPs play a vital role of economic stimulant in developing countries and sustainable growth in global scenario.

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[19] *Implementation of PPP Initiative in India*, at http://www.adb.org/public-private-partnership-operational-plan-2012-2020, visited on September 3,2013

PPP POLICY MAKING: A CRITICAL STEP TOWARDS DEVELOPMENT

- Mayank Kapila[1] and Aakash Saxena[2]

ABSTRACT

The Governments in most of the developing countries face the task in meeting the growing demand for new and specialised infrastructure services. Due to the limited availability of the finances from the traditional sources and restricted capacity in the public sector to implement many projects at one time, governments have resorted to the private sector as an attractive alternative to increase and improve the supply of infrastructure services.

Various governments in the post-modernist era have increasingly turned their focus onto the private sector to provide infrastructure services in important sectors like energy and power, communication, transport and water sectors that were once delivered by the public sector.

Nowadays, each country has framed its own unique approach in soliciting and evaluating the PPP project proposals. Many of them have specially drafted legal instruments concerning the implementation of PPPs. It is likely that the procurement process is also sketched in their legal instruments. Moreover, in other countries, where there is no such special law governing the PPPs, governments normally follow a procurement process in line with the general public procurement process prevalent in that country.

The authors in this paper have analysed the law and the policy making attitude towards PPP projects and their financing in order to develop a better

[1] Assistant Professor of Law, IMS Unison University, Dehradun, Email: mayankapilanalsar@gmail.com

[2] Student, LL.M. II Year, NALSAR University of Law, Hyderabad, Email: aakash.saxena@nalsar.ac.in.

infrastructure. An attempt has also been made to critically examine various stages involved under the Indian policy in PPP projects and whether the approach for their implementation has been streamlined or corkscrewed. For the purposes of the same, various important documents have been studied, including the Draft Public Private Partnership (Preparation, Procurement and Management) Rules, 2011. Further attempts have been made to study the policy making of PPP projects in Europe.

INTRODUCTION: THE EVOLUTION OF PUBLIC PRIVATE PARTNERSHIPS

Public-private partnerships denote a sophisticated interface between public authorities and private sector undertakings, which aims at delivering infrastructure projects, as well as public services.[3] According to the EU institutions, the term public-private partnership refers to the "forms of cooperation between public authorities and the world of business which aim to ensure the funding, construction, renovation, management or maintenance of an infrastructure or the provision of a service."[4] At the European level, as part of the Initiative for Growth, the Council has approved a series of measures designed to increase investment in the infrastructure of the trans-European transport networks and also in the areas of research, innovation, and development,[5] as well as the delivery of services of general interest.[6]

The United Nations (UN) went on similar lines and embraced the

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[3] See European Commission, *Report to the Laeken European Council: Services of General* Interest, COM (2001) 598.

[4] See European Commission, *Green Paper on Public-Private Partnerships and Community Law on Public Contracts and Concessions*, COM (2004) 327.

[5] See Conclusions of the Presidency, Brussels European Council, 12 December 2003, COUNCIL OF THE EUROPEAN UNION, Brussels, 5 February 2004, 5381/04. See also, Communication from the Commission to the Council and to the Parliament "Public finances in EMU 2003," published in the European Economy No 3/2003 (COM (2003) 283.

[6] See COM (2003) 270.

concept, and hence defined public private partnerships asthe innovative methods resorted to by the public sector to contract with the private sector, who bring their capital and other necessaries to complete and deliver projects on time and to budget, while the public sector retains the responsibility to provide these services to the public in a way that benefits the public and furthers economic development and an enhancement in the quality of life.[7]

The UN formulated a scheme to close the ever widening gap between the poorest and the rich, industrialized nations in the UN Millennium Declaration, thus facilitating a new global partnership and underlining the potential of public private partnerships in achieving the realization of the United Nations Millennium Development Goals.[8]

The chief benefit from including the private sector in the distribution of public services has been attributed to the fact that the public sector does not have to pledge its own capital resources in backing the delivery of public services, whereas other benefits include quality improvement, innovation, management efficiency, and effectiveness, the elements that are frequently underlying private sector entrepreneurship.[9] Consequently, the public sector receives value-for-money in the furtherance of public services, while it can also be maintained that through this process the state manages the public finances in a betterand strategically sound manner. Value for money symbolises a conception which is closely associated with the economy, the usefulness and the efficiency of a public service, product or process, i.e., a comparison of the input costs against the value of the outputs and a qualitative as well as quantitative

[7] See United Nations Economic Commission for Europe, Guidebook on promoting Good Governance in Public Private Partnerships, ECE/CECI/4, United Nations, 2008.
[8] United Nations, Millennium Development Goals Report 2011, June 2011, ISBN 978-92-1-101244-6, available at: http://www.refworld.org/docid/4e42118b2.html [accessed 31 July 2013].
[9] P. Grout, *The Economics of the Private Finance Initiative*, 13 oxford review of economic policy 53-66 (1997).

judgment of the mode in which the resources involved have been exploited and managed.[10]

The erosion of confidence in the role of the public sector as organizer and asset holder in the sphere of public services has led to attempts to moderate the widespread dissatisfaction from traditional public procurement methods in delivering public services and infrastructure projects.[11] The outcome discovered that the nexus of contractual relations between public authorities and the private sector were not providing genuine value-for-money outcomes. The criticism has been primarily directed towards: (i) adversarial contractual relations as a result of competitive tendering, (ii) inappropriate risk allocation, and (iii) poor contractual performances resulting in delayed and over-budget completions.[12]

Competitive tendering in public procurement has been reproached for creating a confrontational environment, where the antagonizing relations, which emanate from the tendering processes, are often adversely reflected in the performance stage of the contract. In addition, competitive tendering has been dissociated with innovation and quality. Also, as a result of inefficiently written specifications upon which the tenders have been constructed, the deliverables or the outcomes often differ dramatically from contractual expectations and stipulations.[13]

On the other hand, risk allocation is probably the most crucial element in contractual relations between public and private sectors that affects pricing as well as the overall contractual framework. Risk represents the level of financial

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[10] J. Kay, *Efficiency and Private Capital in the Provision of Infrastructure*, infrastructure policies for the 1990s, organization for economic co-operation and development (1993).
[11] Christopher H. Bovis, *Public-private partnerships in the 21st century*, 11 era forum 379 (2010).
[12] Christopher H. Bovis, *Ec Public Procurement Case Law And Regulation 594* (2006).
[13] Laffont and J. Tirole, a theory of incentives in procurement and regulation (1993).

exposure of a party prior to, after the conclusion of, or during its performance of a contract. In a traditional public contract, risk is apportioned in accordance with the expected modalities, features, or perceptions of the public and private sectors; contractual elements of risk, which are associated with the design or construction of a project, maintenance, and operational matters, are usually passed to the private sector. On the other hand, risks related to the required investment, financing, and currency transactions, planning issues, residualization, obsolescence, political and legal aspects, industrial relations, and usage volumes remain with the public sector.

In traditional public procurement, the risk allocation tends to favour the supply side (the private sector), which mainly relates to the risks pertaining to the process of bidding, including project risks. During the performance stage of the contract till its completion, the public sector would, generally, place an amount of risk to the private sector by requiring performance bonds or other means of financial guarantees. Risk allocation is the result of negotiations between the parties and is normally expected to reflect the pricing element of contractual arrangements between them.[14] Thus, risk allocation and overall pricing for a traditional public contract operate in an analogous relation within a contract. The more risk a party assumes, the higher the price to be paid by the other party, and vice versa.[15]

In traditional public contracts the public sector inevitably accepts excessive risks as a result of its procurement practices. Where the award of publicly funded contracts is predominately based upon the lowest price, which constitutes one of the two permissible award criteria under the procurement rules (the other being the criterion of the most economically advantageous

[14] Christopher Bovis*, Public-Private Partnerships In The European Union* (2013).
[15] Ibid.

offer), this would normally reflect the amount of risk the relevant public sector contracting authorities are prepared to accept.[16]

One of the most advanced Public-Private Partnerships (PPP) programs has been developed in the United Kingdom.[17] The PPPs, including the Public Finance Initiatives (PFI) schemes, are presently responsible for around 24% of the public investment, with projects in most of the key infrastructure areas.[18] Most of the continental European Union states, including Ireland, Sweden, Finland, Germany, Greece, Italy, the Netherlands, Portugal, and Spain, have developed legal and policy frameworks to deliver PPP projects, although their share in total public investment is between five and fifteen per cent. Reflecting a need for infrastructure investment on a large scale, and weak fiscal positions, a number of countries in Central and Eastern Europe, including the Czech Republic, Hungary, and Poland, have embarked on PPPs.[19]

Other countries in the world with significant PPP programs include Canada, Japan, and Australia, particular the state of Victoria.[20] PPPs in most of the above countries focus on infrastructure projects relating to roads and highways, while the United States has significant familiarity with leasing programs in the delivery of public services.[21] Mexico and Chile have established themselves firmly in the use of PPPs to promote private sector participation in public investment projects in South America. In Mexico, PPPs were first used in

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[16] See Directive 2004/18 Art. 26, O.J. L 134, 30.4.2004; see also, Directive 2004/17 Art. 30, O.J. L 134, 30.4.2004.

[17] See H.M. Treasury, *Public Private Partnerships: The Government's Approach* (2000). See also, h.m. treasury, pfi: meeting the investment challenge (2003).

[18] See L. De Pierris, *Improving the Infrastructure*, 40 PFI JOURNAL 44-45 (2003).

[19] See M. Spackman, *Public-Private Partnerships: Lessons from the British Approach*, 26 ECONOMIC SYSTEMS 283-301 (2002).

[20] See Department Of Treasury And Finance, Partnerships Victoria (Melbourne), (2000). See Also, Department Of Treasury And Finance, Practitioners' Guide-Guidance Material (2001).

[21] See, Office Of Management And Budget, Preparation, Submission, And Execution Of The Budget, Omb Circular No. A-11 (2002).

the 1980s to finance highways and, since the mid-1990s, a growing number of public investment projects in the energy sector. There are plans to extend the use of PPPs to the provision of other public services. Chile has a well-established PPP program that has been used for the development of transport, airports, prisons, and irrigation. Brazil is planning significant use of PPPs and there is also a regional approach to infrastructure development across the countries in South America. PPPs have also emerged in Asia, especially in India, Korea, and Singapore, and there is strong interest in PPPs in South Africa.[22]

CHARACTERISTICS OF PUBLIC-PRIVATE PARTNERSHIPS: A PEEK THROUGH THE POLICY-MAKING ASPECTS

Public-private partnerships have been utilized as a credible solution to bridge the infrastructure deficit of many states in both the developed and developing world. PPPs can provide a number of specific benefits to the public sector. In particular, they can offer value for money solutions, where the PPP can attain lower costs, higher levels of service through innovation, and reduced risk for the public sector.[23]

Public-private partnerships possess some distinctive characteristics, when compared with traditional public-private contractual formats. These characteristics reveal a different spirit in public sector administration. The essential characteristic is that the private sector partner is expected to play a strategic role in financing and delivering the infrastructure project or the public service by providing its input into the various phases such as the design, implementation, construction, completion, operation, and maintenance stages of the project. As a result, the duration of the relations between public and

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[22] See D. Grimsey and M. Lewis, *Public Private Partnerships: The Worldwide Revolution In Infrastructure Provision And Project Finance* (2007).

[23]See Christopher Bovis, Risk and Public-Private Partnerships, available at www.lexxion.de/.../e**ppp**l/e**ppp**l.../risk-and-**public-private-partnership**s.html.

private sectors must reflect the need for longevity, in order to allow affordability for reimbursement on the part of the public sector and also the ability of the private sector to recoup its investment profitably. Another characteristic that complements both the strategic role of the private sector and its long-term engagement in delivering infrastructure and public services is reflected in the distribution of risks between the public and private sectors, and in the expectation that the private sector will assume substantial risks. Risk assessment in PPPs is a totally different exercise than the assessment of risk in traditional public contracts.[24]

A range of different risks features in PPPs: construction or project risk, which is related to design problems, building cost overruns, and project delays; financial risk, which is related to variability in interest rates, exchange rates, and other factors affecting financing costs; performance risk, which is related to the availability of an asset and the continuity and quality of the relevant service provision; demand risk, which is related to the on-going need for the relevant public services; and residual value risk, which is related to the future market price of an asset.[25]Moreover, political risks cover a general term used to describe potential risks which may arise out of the external or internal factors that are regulated by governments. External political risks, including currency convertibility, war, sanctions, and political instability may be avoided, mitigated, hedged, or insured against and could be significantly mitigated by actions of the state within which the PPP is structured. On the other hand, internal political risks, like taxation, terrorism, inflation, and industrial unrest are usually uninsurable and could affect the risk allocation within PPPs. Their respective

[24] D. Moss, *When All Else Fails: Government As The Ultimate Risk Manager* (2002).
[25] H. Polackova-Brixi, And A. Schick, Eds., Government *At Risk: Contingent Liabilities And Fiscal Risk* (2002).

mitigation would potentially reflect on the perceptions of the parties in managing such risks. Another essential dynamic of PPPs is that the private sector provides the financing. PPP financing is specialized financing which is different from both public finance and corporate finance. PPPs allow the public sector to access alternative sources of capital.[26]

PPPs seek to transfer risk from the public sector to the private sector. While the provision of private capital and the strategic involvement of the private sector partner in managing the delivery of public services could prove advantageous, significant risk transfer from the public to the private sector is necessary to derive a genuine value-for-money partnership. The impact of risk transfer on financing costs and the pricing of risk to ensure efficient risk transfer are crucial in understanding how risk is treated within public-private partnerships.

The amount of capital required to finance a public-private partnership depends only on the nature and viability of project related risks, instead of the source of its finance. However, the source of financing can influence project risk depending on the maturity and complexity of the risk bearing markets.Within advanced risk bearing markets, it is immaterial whether the project risk is borne by either of the two: the public sector or the private sector. On the other hand, in the case ofless developed risk bearing markets, project risk depends on the vastness of the extent of the risk. Since the public sector can diversify the spread of risk across the taxpayers in general, the usual observation is that this enables the public sector to enjoy an advantage over the private sector in terms of managing the risk concerned. Nevertheless, risk can

[26] See Christopher H. Bovis, *Public Service Partnerships as Instruments of Public Sector Management in the EU,* available at http://www.lexxion.de/pdf/epppl/Reading%20Sample%20Text_Bovis_4-2011.pdf.

adequately be spread across financial markets by the private sector. The most desirable result is likely to be that project risk is lower in the private sector. The ability of the public sector to forcibly cover the risk with respect to the taxpayers, while financial markets have to be provided with an incentive to accept the risk, may prove to be disadvantageous for the private sector concerning the large and risky projects. The scope for the private sector to spread risk will also be considerably limited in the financial markets of the less developed countries.

This outcome might be in contravention to the popular assumption that private sector borrowing generally costs more than government borrowing. However, this mainly reflects differences in default risk. The public sector's power to tax reduces the likelihood that it will default on its debt, and the private sector is therefore prepared to lend to the public sector at close to the risk-free interest rate to finance risky projects. The vital issue is whether PPPs result in efficiency gains that offset higher private sector borrowing costs.[27]

Risk transfer from the public sector to the private sector has a significant influence on whether a PPP is a more efficient and cost-effective alternative to public investment and publicly funded provision of services.The approaches adopted by the public sector and the private sector are quite different from each other in this respect.. The public sector tends to use the social time preference rate (STPR) or some other risk-free rate to discount future cash flows when appraising projects.[28] The private sector in a PPP project wouldinclude a risk premium in the discount rate it is applicable to future project earnings. Under the widely used capital asset pricing model (CAPM), the expected rate of return

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[27] See K. Arrow and R. Lind, *Uncertainty and the Evaluation of Public Investment Decisions*, 60 American Economic Review 364-78 (1970).

[28] See Christopher H. Bovis, Future *Directions In Public Private Partnerships, In The Law Of The Future And The Future Of The Law* 782 (Sam Muller et al. eds., 2012).

on an asset is defined as the risk-free rate of return plus a risk premium, the latter being the product of the market risk premium and a coefficient that measures the variance between the returns on that asset and market returns.[29]

GOVERNMENT INITIATIVE IN INDIA FOR INFRASTRUCTURAL DEVELOPMENT

For a country of India's size, an efficient road network is necessary both for national integration as well as for overall socio-economic development. The National Highways (NH), with a total length of 65,569 km, serve as the arterial network across the country. The four-laning the 5,900 km long Golden Quadrilateral (GQ) connecting Delhi, Mumbai, Chennai and Kolkata has been successfully completed and is now functioning.[30] The ongoing four-laning of the 7,300 km North-South East-West (NSEW) corridor, which was scheduled to be completed by December 2009, is being expedited by the Government with the help of private investment, on recommendations by a Perliamentary panel.[31] While the North South (NS) Corridor Connects Srinagar to Kayakumari, EastWest (ES) Corridor connects Porbandar to Silchar. The East-West Corridor under the National Highways Development Project (NHDP) has seen an expenditure of Rs 27,000 crore so far. [32] The Committee on Infrastructure adopted an Action Plan for development of the National Highways network. An ambitious National Highway Development Programme (NHDP), involving a total investment of Rs. 2,20,000 crore (USD 45.276 billion) up to 2012, has

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[29] Id.

[30] Manu Kaushik, *Highway to Prosperity, Business Today*, May 12, 2013, available at http://businesstoday.intoday.in/story/economic-benefits-of-the-golden-quadrilateral-project/1/194321.html..

[31] The Economic Times, *Road Ministry asks states to expedite East West corridor projects*, August 25, 2013, available at http://articles.economictimes.indiatimes.com/2013-08-25/news/41446001_1_land-acquisition-nhdp-east-west-corridor.

[32] Ibid.

been established. The main elements of the programme are as follows:[33]

1. 100 per cent FDI under the automatic route in all road development projects.
2. 100 per cent income tax exemption for a period of 10 years
3. Cabinet Committee on Economic Affairs (CCEA) has agreed upon the National Highways Fee (Determination of Rates and Collection) Rules, 2008 to establish uniformity in fee rate for public funded and private investments projects.
4. An increment in the overseas borrowing amount of infrastructure sectors, to US$ 500 million from US$ 100 million.
5. Offering cheaper loans for highway projects that will speed up the projects worth more than US$ 12. 70 billion under separate phases of the NHDP.
6. The Ministry of Shipping and Road Transport is considering a 'green corridor' highway project solely for farmers with no toll' charges that would link rural roads with National Highways. This is likely to be developed along with the six-lane project under the NHDP.[34]

PPP IN HEADLINE: PROPOSAL TO SHORTEN ROAD PROJECT APPROVAL PROCESS GETS NOD

The Ministry of Finance has recently accepted a proposal by the Ministry of Road Transport & Highways to shorten the approval process before bids are sought in a move aimed at speeding up projects. The changes will

[33] See Christopher H. Bovis, *Future Directions In Public Private Partnerships, In The Law Of The Future And The Future Of The Law* 782 (Sam Muller et al. eds., 2012).
[34] Available at: http://www.thehindubusinessline.com/companies/power-grid-plans-green-corridor-for-renewable-energy/article3682979.ece.

mergeprojects involving capital up to Rs.500 crores among the existing categories. The road ministry would be accountable for appraisal and approval in a two-step process.[35]

This measure is apparently among the proposals that the Ministry of Road Transport & Highways has pitched in its drive to improve the process of awrding the projects to encourage a greater sectoral investment. The ministry has awarded just 1,010 km of road projects in the last fiscal year up to March compared with the target of 9,500 km. Projects up to Rs.500 crore will be appraised by either the standing finance committee or the expenditure finance committee After an approval by a committee chaired by the roads minister, bids would be invited for the project. For projects ranging from Rs.100 crore to Rs.500 crore, the second committee will have members from the Planning Commission and the finance ministry.[36]

The proposal has been made applicable to both public private partnership (PPP) and publicly funded projects. The projects are currently categorized into three heads on the basis of the programme for highway development of the roads ministry and the mode of financing of the project, which has been further structured on the basis of project cost.[37]

The new classification is limited to two categories, one being PPP and the other one being non-PPP, and then by the cost incurred in the project, i.e., upto Rs.500 crore and above Rs.500 crore. The finance minister has been stated to have been satisfied with the proposals so made, and is looking forward to discuss the same with the Ministry of Finance. However, concerning the

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[35] Ragini Verma, Proposal to Shorten Road Project Approval Process Gets Nod, March 31 2013, available at http://www.livemint.com/Politics/TwGd3EbfEkhhHzhm0AxCMJ/Nod-to-road-ministrys-proposal-for-shortening-project-appro.html.
[36] Ibid.
[37] Ibid.

projects involving a capital infusion of more than Rs.500 crore, the existing mechanism would be resumed PPP projects would be referred to the Public Private Partnership Approval Committee (PPPAC) and others are expected to be refered to the committee chaired by the expenditure secretary, followed by cabinet approval.[38]

ENHANCING THE STABILITY OF THE PPP PROJECTS: BUILDING BLOCKS FOR A BETTER INFRASTRUCTURE

In the face of fiscal and other constraints, governments of most emerging economies have been turning towards the private sector as a means of financing infrastructure development. Many countries have, however, found that it is not always easy to attract the private sector, as the conditions for their participation are, in most cases, different from the traditional method of funding. A closer alliance between various parties involved in the infrastructure development will, however, provide the opportunity to share their views on the risk perspectives, legislative and regulatory environments, which support private investment, project funding packages, project formulation and the means of reducing project preparation and gestation period. It has been empirically proved that "both the public and private sectors have significant effect on each other, the magnitudes of the long-run influence of private production on infrastructure expansion are relatively greater than the reverse for most countries".[39]

<u>Developed Working PPP Systems over the Globe</u>

Many countries have an established PPP programme, including the OECD countries, Australia, Ireland and the US, which has considerable

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[38] Ibid.

[39] Eric C. Wang (2002), *Public infrastructure and economic growth: A new approach applied to East Asian economies,* Department of Economics, National Chung Cheng University, Ming-Hsiung, Chia-Yi 621, Taiwan, ROC, June 2002.

experience in leasing. The PPP projects are also popular in the countries located in the mainland Europe, including Finland, Germany, Greece, Italy, the Netherlands, Portugal and Spain. Considering and realising the need for investments in the infrastructure sector on a higher scale, PPP has been taken up by various countries in Central and Eastern Europe, major of them being Czech Republic, Hungary and Poland. PPP programmes have also been initiated in Canada and Japan. It is noteworthy that the projects in most of these countries are focused on the road and highway development projects. Similarly, the EU Growth Initiative envisages the use of PPP type arrangements predominantly to develop trans-European road network.[40]

While focusing on country specific practices, the Private Finance Initiative (PFI) of the UK is perhaps the best developed government's PPP programme, which also comprises privatisation and other forms of cooperation between the public and private sectors, including the provision of guarantees. The PFI projects are viewed primarily as being about the provision of services, and not about the acquisition of assets. In this endeavour, the private sector makes a long-term commitment to maintain assets and provide services, and the government makes a long-term commitment to procure those services; significant risk is transferred to the private sector; public sector investment projects are considered for PFI where they are likely to represent value for money, and where it meets the UK government's criteria for efficiency, equity and accountability.[41]

Indian Experience in Private Participation in Infrastructure Development

Before the launching of economic reforms in the country, the

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[40] The ECE publication entitled "*Guidebook on Promoting Good Governance in Public-Private Partnerships*", available at <http://www.unece.org/ceci/publications/ppp.pdf>.

[41] Efraim Sadka, *Public-Private Partnerships: A Public Economics Perspective, International Monetary Fund*, WP/06/77, Washington, DC, p. 64.

infrastructure projects were mainly developed by the Government. Since the initiation of the economic reforms, the development of infrastructure has been given thrust through varied means. Along with the initiation of structural reforms in the country, the Government of India has announced new industrial policy in 1991 to develop the industrial and infrastructure sectors, which gave more emphasis on private participation. Policy announcements relating to sector-specific infrastructure developments with the PPP have also been announced in the subsequent annual Budgets of the Union Government. The coverage of the term infrastructure was expanded from time-to-time to enable the sector to avail of fiscal incentives such as tax holidays and concessional duties during the course of their development.[42]

Since the initiation of the reform process, measures were introduced to strengthen the existing infrastructure and to develop new projects with private participation. The private sector participation in the infrastructure building have broadly been taken place through corporatisation of existing PSUs (e.g. GAIL, ONGC, IOC, etc), greenfield investment for development of new projects, PPP in the form of BOT or BOOT model in the road sector and concession agreements with the private sector such as rehabilitate, operate, and transfer; or rehabilitate, lease or rent and transfer; or build, rehabilitate, operate, and transfer basis.[43] Recently established joint venture structure of institutions to develop and modernise the Delhi and Mumbai airports is an apt form of PPP.[44]

According to the PPI database of the World Bank, about 249 infrastructure projects in India have attracted private sector participation and

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[42] Gajendra Haldea, *Public Private Partnership in Infrastructure: A Paradigm Shift*, Planning Commission, GoI, New Delhi, p. 132.

[43] Mohan Rakesh (2006), Economic reforms in India – where are we and where do we go? Public Seminar by the Institute of South Asia Studies, Singapore, November 2006.

[44] Ibid.

reached financial closure between 1990 and 2006, which constituted a share of 6.1 per cent of the total project among 150 low and middle income countries in the world.[45] Of which, transport sector has a major share at 54.2 per cent followed by energy sector at 30.5 per cent during the period.[46] The telecom sector accounted for a share of 13.7 per cent in private participation during the period. Many number of infrastructure projects under private participation have attained financial closure during 2006 particularly in the transportation sector due to mass development of National Highways Development Projects (NHDP) like Golden Quadrilateral and North South-East West Corridor (NS-EW) projects.[47]

Investment requirements of the infrastructure projects are huge and the private sector contribution to the development of public infrastructure has increased many folds during the recent period due to various policy initiatives by the Government towards more encouragement for private participation. However, when compared to other EMEs, private participation in the infrastructure development in India has gained momentum only recently and its share is not much encouraging. India has attracted only about 6.5 per cent of the total investment among 150 low and middle income nations.[48] The investment has flown mainly into the telecom sector which constituted a share of 49.6 per cent of total investment in India, followed by energy sector at 28.9 per cent and transport sector at 21.3 per cent between 1990 and 2006.[49]

Most of the sectors in India have shown infrastructural gaps, thereby

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[45] A Guidebook on Public-Private Partnership in Infrastructure Economic, United Nations Economic and Social Commission for Asia and the Pacific (UN ESCAP), January, 2011, p. 47.
[46] Ibid.
[47] Private Participation in Infrastructure (PPI) Database, Washington DC.
[48] Ibid.
[49] Geethanjali Nataraj (2007), *Infrastructure Challenges in South Asia: The Role of Public-Private Partnerships, ADB Institute Discussion* Paper No. 80, September 2007, p. 107.

endangering the sustenance of the growth momentum. In order to augment the facilities of infrastructure with the participation of the private sector, the infant policy measures have faced an initial setback. Apart from the telecom sector, which has been developing through a revolutionary changeover being able to invite colossal private invstments, the other sectors have recorded a dismal response from the private undertakings. The telecom sector too has only thrived in the terms of overall tele-density, while the rural tele-density has remained at lower levels, which requires adequate policy making and governance measures. .[50]

CONCLUSION

Over the years, the basic infrastructure in India has been developed to an extent, which is not sufficient enough while considering India's geographical and economic size, its population and the pace of overall economic development. Infrastructure bottleneck has been a serious concern in India and basic infrastructure like roads, railways, ports, airports, communication and power supply are not comparable to the standards prevalent in its competitor countries.

To develop world class infrastructure and to remove the infrastructure deficiency in the country, the investment requirements are mammoth, which can not be met by the public sector alone due to fiscal constraints and mounting liabilities of the Government. This would call for participation of private sector in coordination with the public sector to develop the public infrastructure facilities. In this direction, the economic reforms initiated in the country provide for the policy environment towards public-private partnership (PPP) in the infrastructure development. Sector-specific policies have also been initiated

[50] Gajendra Haldea, *Public Private Partnership In Infrastructure: A Paradigm Shift, Planning Commission, Government Of India*, New Delhi, p. 177.

from time to time to enhance the PPP in infrastructure building. While the PPP is spreading to develop basic infrastructure worldwide, in India, the participation of private sector in the infrastructure building has not been much encouraging, despite several rounds of policy reforms.

Taking lessons from the International experience, India should follow the policy making objective of providing enhanced and efficient services to the public at a reasonable expenditure. To achieve the same, realistic and reasonable risk transfer strategies have to be deviced, so that the best practices may be observed to have long term gains with these projects. The primary concern is the availability of a long term funding source, which once figured out by the Government, would expedite the growth of the infrastructure sector of the country, thereby pave way for a unhindered development of the largest democracy across the globe.

STAKEHOLDERS COMMUNICATION IN PPPS –A TOOL FOR PUBLIC SUPPORT

- Rituraj Sinha[1] and Asmita Dhingra[2]

ABSTRACT

Governments around the world are focusing on new ways to finance projects, build infrastructure and deliver services but still in the infrastructure sector they suffer from supply-side constraints due to the delay in the completion of projects resulting from ineffective communication with users and other key stakeholders throughout the Public-Private Partnership project lifecycle. Building consensus among stakeholders must not be neglected as it weakens a project's opportunity for success and sustainability.

An effective communication strategy greatly helps mitigate political, social, economic, technical, commercial risks and clears the path for the acceptability of the projects. The aim of this paper is to find how an effective communication at every stage of the project including identification, preparation, bidding and implementation helps in the successful implementation of the projects.

This paper deals with the examples of many successful and unsuccessful Public Private Partnership projects which demonstrate the requirement of effective communication with the stakeholders for the successful implementation of the project. These examples show that the communication should be lucid, consistent and transparent and should be based on factual and analytical information.

Finally, this paper concludes that an effective communication should address core points including creating awareness and building capacity on Public

[1] Assistant Professor of Law, IMS Unison University, Dehradun
[2] LL.M. (II Year), NALSAR University of Law, Hyderabad

Private Partnership, dispelling misunderstanding about Public Private Partnership and reinforcing the positives to gain the confidence and support of the different stakeholders. It is suggested that a coherent and strategic approach to communication, to inform and to engage stakeholders is decisive to mobilise their broad based positive support for successful development of the project and its implementation.

INTRODUCTION

In India, the key emphasis of all government policies and programmes is the maximum welfare of all its citizens. Eradication of poverty, ignorance, diseases and inequality of opportunities and providing a better quality of life are the nuts and bolts upon which all the plans and blueprints of development are made.

Since the 1990s, there has been a rise in Public Private Partnerships ("PPP") around the world.[3] Today, many developing and developed countries are using the PPP arrangements for improved delivery of services, mostly in the infrastructure sector.[4] The process represents a fundamental shift in the way infrastructure assets are created or services are delivered. It is basically used for public procurement of infrastructure and infrastructure services projects throughout the world. In the present century, PPP is considered as an advanced strategy for societal governance. In simple words, it is a creative enterprise where the best of two sectors i.e. public sector & private sector are brought

[3]Government of India & Asian Development Bank,*Report on Regional Workshop of Chief Secretaries on Public-Private Partnership: Facilitating Public–Private Partnership for Accelerated Infrastructure Development in India* (Government of India, 2006).
[4]Matti Siemiatycki, *Public-Private Partnership Networks: Exploring Business-Government Relationships in United Kingdom Transportation Projects*, 87 Economic Geography 309 (2011).

together to achieve fruitful results.[5] Projects adopting the PPP approach go hand in hand with implementation of reforms and call for significant changes in the present mindset.

With the growing popularity of PPPs as a valuable mode of providing superior quality infrastructure services, there is also a growing recognition of the significance of effective communication with users and other key stakeholders throughout the PPP project lifecycle. This is evident from the fact that many PPP projects have failed due to strong opposition from civil society, local media, and other stakeholders.[6] Public oppositions have also led to cancellations of many projects undertaken under PPPs. The prime reason behind this seems to be the lack of effective communication with the principal stakeholders of the project. Neglect of consensus building among stakeholders weakens a project's opportunity for success and sustainability.[7] It is found that all successful PPPs hint towards the need for an effective communication with the stakeholders comprising of the community, the political establishment and specific user groups both before and after the commencement of the project on all sensitive issues, including rehabilitation and resettlement.

CONCEPT OF PPP

In a competitive global environment, governments around the world are focusing on new ways to finance projects, build infrastructure and deliver services. PPPs are becoming a common tool to bring together the strengths of

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[5]Stuart Macdonald and Tom Chrisp, *Acknowledging the Purpose of Partnership,* 59 Journal of Business Ethics 307 (2005).

[6]Peter Lund-Thomsen, *Assessing the Impact of Public-Private Partnerships in the Global South: The Case of the Kasur Tanneries Pollution Control Project*, 90 Journal of Business Ethics 59 (2009).

[7]Daniele Calabrese, S*trategic Communication for Privatization, Public-Private Partnerships, and Private Participation in Infrastructure Projects*(World Bank Working Paper No. 139, World Bank, Washington DC, 2008).

both sectors. PPP describes a government service or private business venture which is funded and operated through a partnership of government and one or more private sector companies. These schemes are sometimes referred to as PPP or P3.[8]

In addition to maximizing efficiencies and innovations of private enterprise, PPPs can provide needed capital to finance government programs and projects, thereby freeing public funds for core economic and social programs.[9]

Before any further discussion, it is imperative to know what exactly the term PPP means.[10] But defining a PPP is not an easy task as there is no single definition for it. In common parlance, PPP can broadly refer to long-term,[11] contractual partnerships between the public and private sector agencies, specifically targeted towards financing, designing, implementing, and operating infrastructure facilities and other services that were traditionally provided by the public sector.[12] The Government of India has given its own definition of a PPP Project.[13] Accordingly, PPP means a project based on a contract or concession agreement, between a Government or statutory entity on one side and a private sector company on the other, for delivering a service on payment of user charges.[14]

"Public Private Partnership" between a public sector entity (Sponsoring

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[8]Public Private Partnership in India, 1 *Journal of Management and Science* 61(2011).
[9]*Ibid.*
[10]Graeme A. Hodge and Carsten Greve, Public-Private Partnerships: An International Performance Review, 67 *Public Administration Review* 545 (2007).
[11]*Ibid.*
[12]See: http://pppinharyana.gov.in/PPPinHaryana_WhatIsPPP.htm, Visited on September 12, 2013
[13]L. Lakshmanan, Public Private Partnership in Indian Infrastructure Development: Issues and Options 29 *Reserve Bank of India Occasional Papers* 37 (2008).
[14]*Ibid.*

PPP authority) and a private sector entity[15] for the creation and/or management of infrastructure for public purpose for a specified period of time, known as the concession period, on commercial terms and in which the private partner has been procured through a transparent and open procurement system.[16]

These are collaborative ventures based on a contractual agreement which are built around the expertise and capacity of the project partners. This contractual agreement mutually allocates the resources, risks, and returns between the private and public enterprises but it does not refer to reduction of responsibility and accountability of the government.[17] Projects undertaken under the PPPs are generally public infrastructure projects which are dedicated to meeting the crucial service needs of citizens. Hence, the government still remains accountable for service quality, price certainty, and cost-effective value for money of the partnership.

Under the PPP format, the government and the private partner players are assigned two different roles to play. The government acts as a facilitator and enabler, while the private partner plays the role of financier, builder, and operator of the service or facility.[18] The public sector gives assurance of stable governance, citizens' support, financing, and also assumes social, environmental, and political risks. On the other hand, the private sector provides efficiencies, innovative technologies, access to additional finances, managerial effectiveness,

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[15]Private Sector Company means a company in which 51% or more of the subscribed and paid up equity is owned and controlled by a private entity. Private sector entity means- In case of a Company, one that is not within the purview of Section 617 and 619 B of the Companies Act, 1956. For other entities, those which are not controlled by the Government ('control' means the ownership, directly or indirectly through subsidiary(ies), of more than one- half of the voting power of the enterprise).

[16]See: https://ppp.cgg.gov.in/PPPConcept.aspx, Visited on July 15, 2013.

[17]Neil Bradford, Public-Private Partnership? Shifting Paradigms of Economic Governance in Ontario, 36 *Canadian Journal of Political Science* 1005 (2003).

[18]Encouraging Public Private Partnership Optional Reform under JNNURM (JNNURM Primers) p. 2.

and construction and commercial risk sharing. Thus, one sees the merging of the skills, expertise, and experience of both the public and private sectors in the PPPs format. This actually helps in delivering a higher standard of services to customers or citizens.

RELEVANCE OF PPPS IN INDIA

Even in the present century, India faces gaps in the demand and supply of essential social and economic infrastructure and services. Rapidly growing economy, increased industrial activity, burgeoning population pressure, and all-round economic and social development have led to greater demand for better quality and coverage of water and sanitation services, sewerage and drainage systems, solid-waste management, roads and seaports, and power supply. Increased demand has put the existing infrastructure under tremendous pressure.[19] Thus, the demand for better infrastructure and related services has opened the doors for PPP models in India.

India had a few notable and successful PPPs in the early 19th century. The Great Indian Peninsular Railway Company operating between Bombay (now Mumbai) and Thana (now Thane) (1853), the Bombay Tramway Company running tramway services in Bombay (1874), and the power generation and distribution companies in Bombay and Calcutta (now Kolkata) in the early 20th century are some of the earliest examples of PPP in India.[20]

After the opening up of the economy in 1991 there were frequent watchful and tentative attempts for initiating implementation of the concept of PPP projects in India.[21] However, in the initial phases most PPPs were limited to

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[19]AshaGhosh, *Public-Private or a Private Public? Promised Partnership of the Bangalore Agenda Task Force*, 40, *EPW* 4915 (2005).
[20]Government of India & Asian Development Bank *Report: "Facilitating PPP for Accelerated Infrastructure Development in India,"*(Government of India, 2006).
[21]*Supra* note 4, at 137.

the roads sector only. But with time and need, government started implementing the concept in other sectors too.[22]

Today, the top five states account for 58.3% of total value of PPP in India in the major sectors like roads, ports and airports.[23]Maharashtra, Karnataka and Gujarat average around 11% of the total value of PPP of the country, whereas the bottom 10 states represent only 3.5% of the total value of PPP.[24] This indicates the difference in ratio of investment by private sectors.[25]

One appropriate example of a successful model of PPP is the Tripura Project in Tamil Nadu. It is a first privately financed water and sewerage project in India. Other notable examples of successful PPPs are the Noida toll bridge, Tripura water supply project, NHAI, Airports development, and telecom industry.

MEANING OF EFFECTIVE COMMUNICATION

The requirement for an effective communication[26] while developing a PPP project emerges from the major shift in the method of asset formation and service delivery under the PPP mode. PPPs entail moving away from input-based to output-based procurements and involve shifting of operational management of projects from the public to the private sector. Sometimes, PPPs transfer the ownership of assets and/or control of the project to the private sector.

Any project under PPP model attracts a range of responses from

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[22]*Ibid.*
[23]Department of Economic Affairs, Ministry of Finance *Report: PPP Projects Status Report as on 31 July, PPP India Database* (Government of India, 2011), See: http://www.pppindiadatabase.com/Uploads/Status%20of%20PPP%20Projects%20as%20on%20July%2031,%202011.pdf,VisitedonSeptember 12, 2013.
[24]*Ibid.*
[25]*Ibid.*
[26]See:http://siteresources.worldbank.org/EXTDEVCOMMENG/Resources/StrategicCommunicationforPrivatizationPublicPrivatePartnershipsandPrivateParticipationinInfrastructureProjects.pdf, Visited on July 15, 2013.

different stakeholders.[27] These responses can either be enthusiastic and positive, providing support for the project or show different concerns and anxieties about its effects. Therefore, a coherent and strategic approach to communication, to inform and to engage stakeholders is decisive to mobilise their broad based positive support for successful project development and implementation. An effective communication strategy greatly helps mitigate political, social, economic, technical and even commercial risk. It also helps in taking care of users concerns, especially for acceptability.

Objectives of an Effective Communication in PPPs

Effective communication should address core points including creating awareness and building capacity on PPP,[28] dispelling misunderstandings about PPP and reinforcing the positives. It helps in achieving positive behavioural outcomes among stakeholders.

An effective communication focuses on:

a. *Identification of all stakeholders:* It helps in identifying the stakeholders. It helps in knowing the perceptions and behavioural positions of the stakeholders towards the project. This gives a beforehand scenario of the support of the stakeholders towards the project.

b. *Continuous Engagement of stakeholders:-* It is pertinent to engage the stakeholders not only at the initial phase of the project but also at every stage of the project or at a regular interval. This engagement can be done by effective communication with the stakeholders regarding the development of the project and its different effects on the stakeholders. The engagement also helps in

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[27] Peter Lund-Thomsen, *Supra* note 2.

[28] John Forrer, James Edwin Kee, Kathryn E. Newcomer and Eric Boyer, Public-Private Partnerships and the Public Accountability Question, 70 *Public Administration Review* 476 (2010).

building confidence among the stakeholders about their involvement in the project at every stage of it.

c. *Building of trust, credibility, and acceptability:-* Engagement of different stakeholders through effective communication and continuous engagement helps in ensuring transparency of the project development process and also provides adequate opportunities for two-way communication and feedback. This helps in building trust and credibility and knowing the acceptability of the project among the stakeholders.

d. *Bring forth a behavioural change and cooperation:-* Communication is always required for bringing cooperation from the stakeholders for the project's success. This is done by articulating project benefits and impact which finally helps in creating a favourable environment for the implementation of the project.

Benefits of an Effective Communication Strategy in PPPs

An effective communication contributes in achieving success of a PPP project in two ways:

a. Success and failure of every project based on a PPP model depends upon satisfaction of the different stakeholders. This can be achieved by effective communication which helps in identifying current and likely sources of support and opposition for the PPP project in question. It also helps in unearthing existing attitudes across stakeholders on a range of issues.

b. A well-executed communication strategy could contribute in identifying fault lines of a project process. This helps in fine-tuning the project structuring and improving sequencing of the development process, thus creating acceptance, sustainability, and durability of the PPP project.

Examples of an Effective Communication Strategy

a. The Karnataka Urban Infrastructure Development Finance Corporation (KUIDFC) set up a Social Intermediation and Communication Strategy (SICS) Cell for implementing round the clock water supply pilot PPP projects in Hubli-Dharwad, Belgaum and Gulbarga in Karnataka.[29] The negative perceptions about the project among the stakeholders became the biggest hurdles in the success of it. Effective communication was then used as a tool to remove these hurdles. SICS Cell appointed a Non-Government Organisation (NGO) and engaged with residents' associations, teachers, students and youth through public interactions, press releases, and media meets. These efforts and engagements not only helped in the acceptance of the project by the different stakeholders but also helped in timely completion of the project.

a. Political ownership of communication was an important enabling factor in implementing a sewerage system in Alandur, a suburb near Chennai. The Mayor of this municipality started campaigning personally and urging residents to have a say in project construction. He started convincing different stakeholders by providing them the details and benefits of the projects. These efforts helped him not only in gaining the approval of the project but also in the collection of a sum of Rs. 8 crores as a financial support to the project by the different stakeholders.[30]

These cases show the importance of effective communication at every stage of the project which also brings the importance of stakeholder

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[29]See: http://www.kuidfc.com/website/webpage.nsf/lookupAllCat/Projects-KUWASIP-Current%20status%20of%20Contracts, Visited on September 14, 2013.

[30]Government of India *Report: Public Private Partnerships in India: Effective Communication in PPP Projects*, (Government of India, 2010).

involvement and support for successful PPP implementation. Further, they also put forward that communication cannot be handled as a set of isolated events or as a Public Relations exercise.

An Effective Communication is required at Every Stage of a Project

A PPP Project consists of the following phases:[31]

a. *Identification phase:* During this phase, the aim is to get a grasp of the project scope, possible PPP models, points of likely support and concerns, and extent of Government support required in terms of funding and policy.

b. *Preparation phase:* After Identification phase comes the Preparation phase. This phase gives structure to the project for its implementation which translates the concept into a bankable PPP project. It culminates with finalisation of the project's documentation, including the bidding and contractual terms for the proposed PPP project.

c. *Bidding phase:* This phase culminates with a PPP contract being concluded between the project sponsor and the successful bidder identified through the bidding process.

d. *Implementation phase:* In this phase, the successful bidder takes over the responsibility for project construction and operations.

PROJECT IDENTIFICATION PHASE

The important outcomes of the Project Identification phase are:-[32]

a. scale and scope of the project,

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[31]See:http://toolkit.pppinindia.com/urban-transport/module1-ootpp.php?links=ootpp1, Visited on September 12, 2013.

[32]See: http://siteresources.worldbank.org/INTTRANSPORT/Resources/336291-1304446506690/PPP_Phases_DKryschenko_April2011.pdf,Visited on September 14, 2013.

b. an initial assessment of the concerned stakeholders, and

c. the kind of support, in terms of policy and funding, needed from the Government.

Firstly there should be mapping of all the stakeholders that can make an impact on the success of the project. During this phase, this kind of mapping is necessary from the communication point of view. During this phase, there should be consultation with the Government, bureaucrats, and sometimes political leaders for the proper initiation of the project. This kind of communication includes visits to the project site and dipstick surveys and interactions with the concerned stakeholders. It can be said as a clear communication to the stakeholders only when it touches three basic and important aspects of the project:-

a. What are the needs, expectations and views of stakeholders on the project?

b. How can one meaningfully segment stakeholders in the context of the PPP project?

c. How should a Practitioner deal with varying degrees of support and resistance of the stakeholders and the underlying causes of such behaviours?

PROJECT PREPARATION PHASE

The project identification phase follows the project preparation phase. In this phase an identified and approved project idea is translated into a bankable and well-structured PPP project opportunity. In a way this phase helps in starting a project with a proper roadmap. It involves establishment of the project specifications and viability, crystallisation of the proposed PPP model and finalisation of the bidding and contractual terms. During this phase, the

focus should be on getting wider support, assurance and credibility for the project among stakeholders by an effective communication. There are different kinds of stakeholders involved at this phase. Thus, the main focus should be on convincing them about:

a. Benefits of the Project

b. Past positive impacts of the project.

c. Assurance about the intended outcomes,

d. Aspiration showing the innovative characteristics of the project that can instil a sense of pride among the stakeholders.

e. Credibility

Different Stakeholders During This Phase

a. Users:-

The main concerns of the users revolve around the tariffs/costs and service quality of the projects. They expect a clear picture about the projects because it involves their own money. These can be addressed by a clear articulation of project features that reinforce positive expectations and allay concerns. Further concerns on costs/tariffs can be assuaged by appropriate comparisons.

b. Employees

The other stakeholders are the employees involved in the project at this stage. In one way or the other these PPP projects have an impact on the employees. Recognising employees as a vital stakeholder right from the start of the project will help in incorporating aspects of employee welfare, skill building

and safety practices in the project design. Some points to be noted in this regard are:

- Communication with employees should focus on the potential benefits to employees such as skill development, wage improvement, employee welfare and human resources' best practices which are the outcomes of the project.

- Communications should aim at giving a factual position about the projects to the concerned labour unions and employees. In addition to these, they should also be communicated about the possible alternatives and redress mechanisms available with them.

- Since PPP is a new concept in India, labour unions and employees may not be familiar with the different concepts involved in it. Thus, it becomes necessary to bring to their knowledge about the pros and cons about the model. This can be done by conducting capacity building and training sessions on PPPs through a series of consultations during project development and implementation. This will induce confidence in them and help in the completion of the project without any hindrance.

- Another way of getting confidence is by drawing comparisons between the old projects and new projects. This can be done by giving details of the similar past projects in other parts of the country which have yielded positive impacts for the employees and other people. This would help in creating a favourable atmosphere among the employees.

c. *Political Leaders:-*

Getting support from political leaders is as important as getting support from other stakeholders but this needs one-to-one consultations with them. An

effective communication with political leaders is must for inspiring confidence in order to display the public goodwill potential of the project. Once we get their support in the early stage of the project, it becomes easy to get the support of others. Communication should create enthusiasm and excitement about the project to get their active support and advocacy. It should help in instilling satisfaction by stressing the inspirational aspects of the project and to drive the political leaders to turn into dynamic supporters of the project.

Making a comparative analysis between the old and the new projects again helps in getting support of the political leaders. This can be done by providing extra guarantee by demonstrating precedence through visits to successful projects and peer-experience sharing interactions with other political leaders who have a positive experience to share.

d. Private Sector:-

Communication with the private sectors during the Project Preparation phase is normally limited. In reality the private parties which are involved in the projects are the only stakeholders. This needs a proper identification of the parties which are really interested in becoming a part of the project. There should be proper compilation of a database of the potential bidders in the project. Since PPP is a relatively new concept in India and private parties are reluctant to be part of it. This is because they do not understand the benefits associated with it. The simplest way to convince them of the advantages is by interacting with them on different issues ranging from project design to structuring options. This will instil confidence among them regarding the progress of the project in a right direction. This may require taking steps beyond just identification and compilation. There should be an initial round of bidder engagement through road shows on the project concept and through

consultations on different concerns that may arise during the completion of the project.

e. Media:-

Media plays an important role in mobilising public support. Nowadays public, to some extent, blindly believes the contents shown on different news channels and printed in newspapers. It becomes necessary to bring them into confidence as a negative portrayal in front of the public may affect the progress of the project. Such reports may sow doubts and concerns in the minds of the public-at-large which may become difficult to remove later. The communication with the media should be transparent and pro-active. If the same is communicated to the public by the media, it becomes an easy task to gain support of the public-at-large. This kind of engagement helps in the smooth progress of the project. Thus, an effective communication with the media should start during the Project Preparation Phase itself. If this is not done, the media reports surrounding the project can get distorted.

The specific actions that need to be taken are the following:

- There should be proper communication to the journalists about the project. The media should know in advance about the benefits and rationale behind the project. This kind of an engagement should be periodic starting from the initial stage to every stage of the project. This helps in giving a correct picture to the public about the project.

- For the larger and more sensitive PPP projects, engagement has to be more intensive and requires periodic press meets/briefings.

In a nutshell, the Project Preparation phase converts the understanding of stakeholders' behavioural dispositions during Project Identification and the

early stages of Project Preparation phase into appropriate communication actions. They are significant in setting the stage for a conducive environment for the Project Bidding phase. It has to be ensured that this positive environment is 'maintained' through effective communication with the concerned stakeholders.

BIDDING PHASE

Success of a project depends upon the amount of investment involved in it. Thus, bidding becomes an important exercise for attracting investors or private developers. There should be a proper communication with the potential bidders who can bid in the project and provide necessary financial support to the project. The bidders should know in advance about the returns they will get on the completion of the project. Further, an effective communication also leads to a fair contest among the competent private developers. Communication during this phase should always signal the transparency and integrity of the bidding process by transparent and equitable sharing of information with all stakeholders.

Different Stakeholders During This Phase

a. *Private Sector:-*

The process starts with the identification of the interested bidders, which are generally the private parties. An effective communication with the bidders plays an important role in identification. Thus, in order to maintain a contest in the bidding process, effective communication is required with the private sector. This includes proper engagement with them through a series of pre-making efforts like contacting, marketing, sharing preliminary information about the project and also by highlighting the facets of the project that make it an attractive investment opportunity.

b. *Other Stakeholders*

Although the success of this phase depends upon the effective communication with the interested bidders, we cannot ignore the other stakeholders. Thus, an effective communication is required with the other stakeholders also. These stakeholders should be communicated in the form of pre-bid meetings, information dissemination and sharing over the website.

The main concern of the communication during this phase is to keep all the government stakeholders informed about the progress and prospects of the project. All the users, political leaders, advocates, etc. should be properly communicated with and actively consultated in this phase to keep them updated about the project.

PROJECT IMPLEMENTATION PHASE

During the Project Implementation Phase, the successful bidder takes over the responsibility of subsequent operations of the project. The burden of communication now shifts to the successful bidders. They should engage themselves in a range of communication actions to increase awareness about the project with the aim of showing the benefits associated with it. The success of this phase also depends upon the proper communication with the other government agencies and their co-ordination with the successful bidders.

Different Stakeholders During This Phase

a. Users:-

Communication with users during this phase should typically address issues pertaining to creation of awareness, consumer care, and benefit reinforcement. A proper notification should be issued for the users to educate them regarding the nature and types of services to be used before and after the project implementation phase. For instance, implementation of a toll road may

require awareness creation amongst pedestrians for using foot over-bridges to cross the road.

The successful bidder should also create awareness among the concerned persons regarding the means of redressing grievances and compensation mechanisms that could be accessed by them. For instance, land acquisition may be initiated in some cases after the project has been awarded, while noise or air pollution on account of a new toll road arises after the project commences operations.

b. *Government:-*

At this phase of the project a planned co-ordination and reporting on project progress, service delivery and corrective actions is required between the Project Sponsor, Successful Bidder and other agencies in order to facilitate smooth communication and implementation of the project and to improve credibility and trust towards the project.

c. *Developer:-*

The implementation agency and the successful bidders should have an understanding of contractual obligations. This can be achieved by an effective communication between them which should focus on resolving non-compliances done in different phases of the project. At the same time the Project Sponsor and the Successful Bidder should also collectively work for ensuring communication with users and other stakeholders.

Some guidelines that may be suggested in this regard are:

a. There should be proper engagement of the stakeholders at the start of Project Implementation phase .The communication should be regarding sharing

of responsibility between them by properly informing their respective roles in the completion of the project.

b. When a project reaches at the completion stage, the project experience should be widely publicised in order to create wider awareness of such positive outcomes.

CONCLUSION

Infrastructure bottleneck is a serious concern in India for its developing economy. Many developed and developing countries have developed their infrastructure successfully either through private participation or through PPP model but India still struggles in participation of private sectors in the process of infrastructure.[33]Every country needs infrastructure for development, to provide basic services to the citizens; which requires assistance from the private sector also. Thus, countries with limited resources cannot overlook these sectors which are equally interested in investing in different projects related to infrastructure. But absence of effective communication with the different stakeholders including private parties hinders the success of a project. Thus, stakeholder communication is the essential requisite to influence stakeholders' perception and behaviour to gain support for reforms.

Effective PPPs recognize that the public and the private sectors each have certain advantages, relative to the other, in performing specific tasks.[34] An effective way of communication among stakeholders plays an important role in the successful implementation of PPP programmes and projects. Engaging key stakeholders through an effective communication strategy and addressing their

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[33]*Supra* note 11.

[34]Asian Development Bank, *Public-Private Partnership Handbook*, (ADB, 2006), See: http://www.apec.org.au/docs/ADB%20Public%20Private%20Partnership%20Handbook.pdf, Visited on July 15, 2013.

concerns, needs and expectations about the project helps in gaining trust and support for the successful implementation of the PPP project.

Before the start of the first phase of the project there should be proper identification of the stakeholders. The identification should be phase-wise. Secondly, there should be proper estimation of their needs, perceptions and behavioural position towards the PPP project. Thirdly, there should be complete engagement in such a way that it either alleviate their resistance or muster their support for the PPP project.

For making the communication effective, it should be lucid, consistent, transparent, credible and based on factual and analytical information. Thus, an effective communication in a PPP does not happen by default, it has to be achieved with an appropriate communication tool. It actually requires utmost attention by the management including through adequate allocation of right-mix of financial and human resources for communication interventions.

SEBI'S JURISDICTION OVER CORPORATE GOVERNANCE— A CRITICAL ASSESSMENT

- Abhishek Sudhir[1]

ABSTRACT

The realm of SEBI's regulatory authority has been the subject of intensive debate and there are doubts as to whether SEBI can pass regulations on corporate governance matters that fall within the jurisdiction of the Ministry of Corporate Affairs. In order to determine the extent of SEBI's jurisdiction, this paper examines when, how and under what circumstances SEBI can make regulations on issues concerning corporate governance. This paper aims to demonstrate how SEBI, by implementing corporate governance legislation through Clause 49 of the listing agreement that companies sign with stock exchanges, has created a situation whereby various provisions of the listing agreement are derogatory to and in conflict with the Companies Act, 2013. Particular attention is therefore paid to the changes proposed by SEBI in its 'Consultative Paper on Corporate Governance' on independent directors and limits on managerial remuneration on the basis that it is an abuse of a related-party transaction. Following a critical assessment of SEBI's jurisdiction over corporate governance the paper comes to two conclusions. The first is that SEBI does not possess the jurisdiction to pass regulations on matters solely concerned with corporate governance and by doing so they are acting *ultra vires*. The second is that, as SEBI enjoys considerable support from various quarters to regulate corporate governance, Parliament must pass enabling legislation to ensure that SEBI does not continue to act *ultra vires* its powers.

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[1] LL.B. (Hons), LL.M. in Corporate Laws (Merit), Pg. Dip in Legal Training for the Bar (Very Competent), Bar-at-Law (Gray's Inn, London), Advocate (Karnataka State Bar Council).

INTRODUCTION

A vibrant capital and securities market is an important financial institution and its depth is often considered a measure of economic development and stability. As a result, dealings on the securities market must be fair and incapable of manipulation to ensure that the market is driven by the economic forces of demand and supply.[2] With this in mind, the Securities Exchange Board of India ("SEBI") was established in the year 1988 to promote the orderly and healthy growth of the securities market and for investors' protection. SEBI has evolved as a very mature and responsible gatekeeper in the last 25 years by regulating Indian companies wishing to raise money through shares and securities. As the primary regulatory authority for listed companies in India, corporate governance has been high on SEBI's radar. While the corporate governance efforts in India have been spearheaded by SEBI over the last decade, the more recent steps have been taken by the Ministry of Corporate Affairs ("MCA"). There has been a conscious effort on the part of the MCA to consolidate SEBI's corporate governance norms into the erstwhile Companies Act, 1956. With a view to further improving corporate governance standards, the Companies Act, 2013 ("Act"), after a lengthy legislative and consultative process involving various stakeholders, was passed by Parliament in August 2013. Towards that end, the Act does contain several aspects of corporate governance which have hitherto been the mainstay of regulations imposed by SEBI. According to the Indian Institute of Corporate Affairs, this represents a trend towards legislating on corporate governance rather than leaving it to the

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[2] G.N. Bajpai, *Significance of Securities Market in the Growth of an Economy: An Indian Context* (2003) http://www.sebi.gov.in/chairmanspeech/chsp4.pdf, visited on September 13, 2013.

domain of SEBI regulations.[3] It also signifies a shift in corporate governance administration from SEBI towards the MCA, which administers the Act. Over the years, SEBI has repeatedly made significant amendments to the listing agreement which governs the terms on which the securities of a company are listed on the exchange to substantially increase the responsibility of listed companies. Some have argued that SEBI was never granted the jurisdictional authority to impose corporate governance rules in this fashion.[4] It is the central purpose of this paper to carry forward this debate. In order to achieve this purpose certain fundamental questions about the jurisdiction of SEBI's rule-making powers vis-à-vis the Act need to be addressed.

EXTENT OF SEBI'S JURISDICTION: SEBI ACT, 1992 AND THE COMPANIES ACT, 2013

The Companies Act, 2013 is the primary law governing all companies in India and lays down *inter alia* the basic rules for issue and transfer of securities by companies and issue of dividends by companies. The Central Government i.e. the MCA (acting through the Registrar of Companies and Regional Director, in most cases) is the main regulatory authority under the Act.[5] The Securities Contracts (Regulation) Act, 1956 ("SCRA") was enacted to regulate the formation and operation of recognized stock exchanges, which power is concurrently held by the MCA and SEBI. Parliament enacted the SEBI Act, 1992 ("SEBI Act") to provide for the establishment of a Board to regulate the securities market and protect investors' rights through adequate, accurate and authentic disclosure of information on a continuous basis. The Supreme Court

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[3] Indian Institute of Corporate Affairs, *Corporate Governance in India: Policies to Reality* (2012) p.22. http://www.iica.in/images/Corporate_Governance.pdf , visited on September 13, 2013.

[4] A. Afsharipour, *Corporate Governance Convergence: Lessons from the Indian Experience,* 29 Nw. J. Int'l L. & Bus. 335 (2009)

[5] Ministry of Corporate Affairs, Government of India, *About MCA*, http://www.mca.gov.in/Ministry/roc.html, visited on September 13, 2013.

has recommended a harmonious construction of the various provisions of the Act and the SEBI Act on the basis that the latter is a special law, in itself containing elaborate provisions to protect the interests of investors.[6] One such provision is sub-section (1) of Section 11 of the SEBI Act which casts an obligation on SEBI to protect the interests of investors in securities, to promote the development of the securities market, and to regulate the securities market, 'by such measures as it thinks fit'. The Supreme Court's interpretation of this provision is that the measures to be adopted by SEBI in carrying out its obligations are couched in open-ended terms, having no pre-arranged limits.[7] Thus the nature and manner of measures which can be adopted for giving effect to the functions assigned to SEBI have been left to the discretion and wisdom of SEBI.

The MCA has always insisted that the provisions of the SEBI Act should be read as provisions additional to Section 55A of the erstwhile Companies Act, 1956, which has been reproduced as Section 24 in the new Act. Section 24 confers jurisdiction on SEBI with regard to three categories i.e. issue of securities, transfer of securities and non-payment of dividend. SEBI has conceded that powers relating to 'all other matters' mentioned in the explanation to the aforementioned section i.e. matters other than those relating to the issue and transfer of securities and non-payment of dividends would be exercised by the MCA or the Registrar of Companies and not SEBI.[8] SEBI's view is that the explanation to Section 24 has to be read harmoniously, and if so read, clearly spells out the powers of SEBI and the MCA. The MCA has also emphasised that that there is no overlap, much less any repugnancy or conflict

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[6] *Sahara India Real Estate Corp Ltd* v. *SEBI* (2013) 1 SCC 1 at 57.
[7] Ibid. at 158.
[8] Ibid at 50.

of jurisdiction between the provisions of the Act and the SEBI Act.[9] One view is that Section 24 gives powers to SEBI with respect to subjects mentioned therein only and clarifies that with respect to the rest, the jurisdiction would be vested with the MCA. It has been made clear in Section 32 of the SEBI Act that its provisions 'shall be in addition to and not in derogation of the provisions of any other law for the time being in force'. While it is beyond dispute that the Act recognises SEBI as an enforcement authority for administering certain specific sections, it nevertheless has to enforce those sections under the aegis of the Act. It cannot resort to the provisions of the SEBI Act to enforce the provisions of the Act in the absence of an enabling provision. SEBI must therefore acknowledge that its powers are limited and subordinate to the MCA and not coextensive with it[10] and, hence, it has to refrain from framing its own rules concerning corporate governance However, this is precisely what SEBI has done through its use of Clause 49 of the listing agreement.

CLAUSE 49: PROPOSED CHANGES IN SEBI'S CONSULTATIVE PAPER ON CORPORATE GOVERNANCE

In January 2013, in anticipation of the passage of Act, SEBI floated a consultation paper on review of corporate governance norms in India, with a view to addressing inconsistencies in the listing agreement vis-à-vis the Act. In the paper, SEBI argued that 'while it needs to be ensured that the proposals suggested would not result in increasing the additional cost of compliance by a huge margin and that the cost should not outweigh the benefit of listing, at the same time, it is necessary to bring back the confidence of the investors back to the capital market, for channelizing savings into investment, which is the need

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[9] Ibid. at 52

[10] *Gold Multifab & others v. SEBI* (2003) 4 Comp LJ 361 (SAT).

of the hour'.[11] While SEBI acknowledged that the entirety of Clause 49 would have to be revisited to ensure it was consistent with new Companies Act, it argued that it could impose more stringent conditions on listed companies through the listing agreement, than those contained in the Act, considering the need to have better governance practices in listed companies, provided those regulations were not derogatory to the provisions of the enactment.[12] It is worth considering some of these 'more stringent conditions' so as to assess whether or not SEBI will be acting *ultra vires* by implementing the proposed changes through the listing agreement.

INDEPENDENT DIRECTORS

A core principle of corporate governance that the Act and SEBI seek to address is the independence of directors by ensuring they have the requisite qualifications to contribute effectively towards corporate governance. The academic literature suggests that independent directors may be seen as watchful monitors of the promoters and management on behalf of the public shareholders.[13] Company laws in various jurisdictions make it mandatory for independent directors to be appointed to the Board of listed companies so as to protect the interests of the minority shareholders vis-à-vis the interests of a major or controlling shareholder.[14] In India, the minority shareholders of a listed company are primarily members of the public who have invested in the company by purchasing shares and securities on the stock exchange. SEBI can therefore claim the jurisdiction to pass regulations pertaining to independent directors as by doing so they are protecting the interest of investors in securities

[11] The Securities and Exchange Board of India, *Consultative Paper on Review of Corporate Governance Norms in India* (The Securities Exchange Board of India, 2013) at para.9.4.
[12] Ibid at para.7.2.
[13] V. Khanna and S. J. Mathew, *The Role of Independent Directors in Controlled Firms in India: Preliminary Interview Evidencer,* 22 (1) National Law School of India Review 35 (2010)
[14] Ibid. at 51.

by 'such measures as they think fit'. The Act has taken some positive steps in this regard by mandating under Section 149 (4) that the Board of 'every listed company' must appoint at least one-third of its directors as independent directors. However Clause 49(1)(a) of the listing agreement goes further, specifying clearly that the Board of a listed company should not have less than fifty per cent of the Board comprising non-executive directors. The agreement further stipulates that if the Chairman of the Board is a non-executive director, at least one-third of the Board should comprise independent directors and in case he is an executive director, at least half of the board should comprise independent directors. In addition the agreement stipulates that if the non-executive Chairman is a promoter of the company or is related to any promoter or person occupying management positions at the Board level, or at one level below the Board, then at least one-half of the Board of the company will consist of independent directors. Thus, if the Chairman of the Board is an executive director but independent directors form only one-third of the total strength of the Board, then the Company would be in violation of the listing agreement but not Section 149 (4) of the Act. In September 2013 the MCA attempted to remedy this conflict by issuing draft rules under Section 149(4) of the Act so as to ensure that listed companies would have to comply with more stringent requirements of Clause 49(1)(a) of the listing agreement.[15] Such an undesirable situation, whereby Section 149(4) is effectively overruled, is brought about by the conflict and overlap of jurisdiction between SEBI administering the listing agreement and the MCA administering the Act.

RELATED-PARTY TRANSACTIONS

Another area of concern that the Act and SEBI seek to address is the

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[15] Government of India, *Draft Rules (1st Phase) Under Companies Act 2013* (Ministry of Corporate Affairs, 2013) Chapter XI.

abuse of related-party transactions ("RPT") by majority shareholders. Abusive RPTs may be used for personal aggrandisement of controlling shareholders, especially in Asian jurisdictions, which are characterised by concentrated shareholdings. This, according to SEBI, dents the confidence of the investors and jeopardises the process of channelizing savings into the capital market.[16] With these concerns in mind Section 188 of the Act mandates that certain RPTs will need the approval of a majority of disinterested, public shareholders, thereby reducing the majority shareholder or promoter to a non-voting bloc. The provisions in the Act introduce the need to obtain a special resolution of the shareholders for approving any transactions proposed to be entered into with the related parties. Members who are themselves related parties are restricted from voting on such resolution. Nevertheless, the Act has carved out an exception from the approval process, in case the Company is able to establish that such transactions are entered into in the ordinary course of business on an arm's length basis. An arm's length transaction is defined as a transaction between two related parties that is conducted as if they were unrelated, so that there is no conflict of interest.[17] While the Act does not prohibit a company from entering into a RPT that is not at arm's length, the Board is required to provide its reasons for entering into any RPTs to the shareholders in its report. In its consultative paper, SEBI proposes to impose more stringent compliance rules with regard to companies obtaining prior approval of the Board and the shareholders before entering into RPTs. One RPT that SEBI is concerned about is the remuneration paid to CEOs in listed Indian companies, which, according to SEBI, is far higher than the remuneration received by their foreign

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[16] Supra note 11 at para.11.25.

[17] Ministerial Notification G.S.R.739(E) dated 07.12.2006. http://www.mca.gov.in/Ministry/notification/pdf/AS_18.pdf, visited on September 13, 2013.

counterparts with no justification being given to that effect.[18] In line with the above, SEBI in its paper has not only proposed 'majority of minority' approval for all major RPTs but has gone the extra mile by proposing to extend the Section 188 'majority of minority' requirement to the approval of managerial remuneration beyond a particular limit as well.

The first issue that needs to be considered, so as to assess whether SEBI has the jurisdiction to extend the requirements of Sections 188 in this manner, is whether the approval of managerial remuneration beyond a particular limit is an RPT. Parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions. RPTs involve a transfer of resources or obligations between related parties, regardless of whether or not a price is charged.[19] Based on the above definitions it would be plausible to conclude that the promoters, who have a dominant holding in the company, control the Board and as a result would be able to exercise significant influence over those managerial personnel that they have appointed. SEBI's view that the excessive managerial remuneration paid to executives forming part of the promoter's group constitutes an abusive RPT would appear to be valid. However, for SEBI to mandate the need for approval by disinterested/minority shareholders of managerial remuneration beyond a particular limit they will have to show that they have the jurisdiction to regulate RPTs under the SEBI Act. As RPTs involve parties who can control the terms of a transaction in their favour potentially at the cost of the company, they affect the interests of the investors in the company in general. Thus, under Section 11 of the SEBI Act, SEBI has the right to regulate abusive RPTs as they

[18] Supra note 16.
[19] Supra note 17.

can have a detrimental effect on the finances of the company thereby affecting the interests of those who have invested in the company through the securities market.

The second requirement of the SEBI Act that SEBI will have to satisfy is that the regulations will be in addition to and not in derogation of the provisions of the Act. SEBI invokes its jurisdiction to regulate managerial remuneration as an RPT by relying on Section 188 of the Act. However it is not entirely clear as to which provision of Section 188 renders the approval of managerial remuneration by interested parties an RPT. RPTs that require the approval of disinterested shareholders amongst others include: buying and selling property of any kind; leasing of any kind of property; and a related party's appointment to any office or place of profit in the company, its subsidiary company or associate company. The argument that the related party's appointment to an office of profit in the company extends to the amount of remuneration to be paid to them is at best a plausible argument that SEBI can make to impose the 'majority of minority' approval requirement. A more compelling argument for SEBI to make would be to rely on the wider provisions on managerial remuneration in the Act. For example Section 197 of the Act requires every listed company to disclose the ratio of the remuneration of each director to the median employee's remuneration. Further, Section 197 also specifies that the total managerial remuneration payable by a public company to its directors, including managing director and whole-time director, and its manager in respect of any financial year shall not exceed eleven per cent of the net profits of the company in that financial year. Limits on the amount of managerial remuneration emerge as a core principle of corporate governance in the Act that SEBI could have relied on to invoke their jurisdiction. However in their consultative paper they chose to rely on Section 188 of the Act on

abusive RPTs as by doing so they can mandate the strict 'majority of minority' approval for managerial remuneration. In the section titled 'Abusive RPTs' in its consultative paper, SEBI proposes the application of the Section 188 requirement prohibiting interested shareholders from voting on approving RPTs. If the Section 188 requirement is incorporated into Clause 49 of the listing agreement then, in the absence of the arm's length exception, a promoter who is an interested party were to vote on the approval of remuneration of managerial personnel beyond a certain limit that he/she appointed, failure to obtain the approval of disinterested shareholders will amount to an abusive RPT. A promoter would therefore be deprived of arguing that the transaction, namely the increase in the remuneration of certain managerial personnel, was entered into in the ordinary course of business on an arm's length basis. As SEBI's paper makes absolutely no mention of the arm's length exception provided for in Section 188, the imposition of the 'majority of minority' requirement through Clause 49, in addition to the fact that it may be *ultra vires* their powers to regulate managerial remuneration, will lead to a conflict and overlap between the listing agreement and the Act. Similar conflicts also arise in relation to the constitution of the Audit, Nomination and Remuneration Committees. SEBI's paper proposes to retain the stricter requirement that the Chairman of the Audit, Nomination and Remuneration Committees of a listed company should be an independent director despite the fact that Sections 177 and 178 of the Act only mandate that the Chairman must be financially literate.

CONFLICTING PROVISIONS

These conflicting provisions between the listing agreement and the Act will have an adverse impact on a listed company's ability to ensure compliance with its corporate law obligations. There is no doubt that if the stricter provisions proposed in SEBI's paper are implemented and monitored it will go a

long way in ensuring that independent directors are truly independent. However, going by the current structure, the proposed definition will mean that many directors who are presently treated as independent will no longer be so. Moreover given the more stringent norms, particularly the exclusion of promoters/relatives of promoters of the company including those of the holding/subsidiary /associate company, companies may find it a bit difficult to identify and appoint the required number of independent directors and may have to restructure their board sizes.[20] As far as abusive RPTs are concerned, a failure to comply with the stricter provisions that SEBI proposes to impose through the listing agreement will render the transaction voidable in addition to penal consequences. Judging by the draft rules issued by the MCA listed companies will have to follow the stricter provisions of the listing agreement to be on the right side of the law. This is because, apart from the basic provisions of the Act, every listed company has to comply with the provisions of the listing agreement they sign with stock exchanges as per Section 21 of SCRA. Non-compliance with the listing agreement can lead to delisting under Section 22A or monetary penalties under Section 23E of the SCRA. On an almost daily basis, SEBI issues directions under Sections 11 and 11B of the SEBI Act barring companies from dealing in securities or accessing capital markets or being associated with capital markets for failing to comply with the listing agreement. It is therefore imperative for the MCA to ensure that when SEBI imposes more stringent requirements through the listing agreement by invoking their jurisdiction over corporate governance they are not acting *ultra vires*.

SEBI AS A GATEKEEPER OF CORPORATE GOVERNANCE: GOING BEYOND

[20] Ingovern Research Services, *Views on SEBI's Consultative Paper on Corporate Governance Norms in India* http://www.ingovern.com/wp-content/uploads/2013/02/InGovern-Views-on-SEBI-Consultative-Paper-on-CG-Norms.pdf , visited on September 13, 2013.

ITS MANDATE

SEBI acts as a gatekeeper of corporate governance by imposing the stringent requirements of the listing agreement on the basis that it is in the 'interests of the securities market'. Expert committees set up by the Central Government and SEBI have commented on this practice of SEBI going beyond its mandate on certain corporate governance matters. The Naresh Chandra Committee stressed in 2002 that SEBI should refrain from exercising powers of subordinate legislation in areas where specific legislation exists in the Companies Act.[21] The Committee's report also suggested that if any additional requirements were sought to be prescribed for listed companies, then in areas where specific provisions existed in the Act it would be appropriate for SEBI to have the requirements prescribed in the Act itself, through a suitable amendment.[22] The Narayana Murthy Committee, in 2003, also suggested that major differences between the requirements of the listing agreement and the provisions of the Act should be identified and SEBI should then recommend to the Government that the provisions of the Act be changed to bring it in line with the requirements of the listing agreement.[23] On the basis of these reports, a critic, who was of the opinion that SEBI was overstepping its authority through its use of Clause 49, observed in 2003 that SEBI could 'adopt the Companies Act provisions concerning dividends and transfer/issue of shares for listing agreements', but could not 'frame independent rules of corporate governance that go beyond their mandate and say that their non-compliance would affect

[21] Government of India, *Report: Recommendations of the Naresh Chandra Committee on Corporate Audit and Governance* (Ministry of Corporate Affairs, 2002) at para 5.1.
[22] Ibid.
[23] N.R. Narayana Murthy Et al., *Report of the Committee on Corporate Governance* (The Securities Exchange Board of India, 2003) at para 5.2.

listing. Doing so would be *ultra vires* its powers.'[24] Ten years on these very same concerns can be raised again.

These concerns have been dismissed by the MCA which, by relying on the Government appointed Irani Committee's report, has insisted that the perception in some quarters as to the need to demarcate the respective jurisdictions of the MCA and SEBI is misplaced.[25] In the MCA's view, the Central Government, acting through them, is required to exercise the sovereign function and discharge the responsibility of the State in corporate regulation. Whereas SEBI, in their view, as a capital markets regulator, has distinct responsibilities in regulating the conduct of the intermediaries' capital market and interaction between entities seeking to raise and invest in capital.[26] The Parliamentary Standing Committee on Finance asked the MCA to refrain from passing regulations on capital issuances to the public as by doing so they would avoid any regulatory overlap and confusion with the detailed regulations laid down by SEBI.[27] However, the Committee was of the view that the MCA should still set out guidance in the Act itself for SEBI to draft detailed regulations. The MCA responded by stating that the provisions in the new Act would be in accordance with the Committee's recommendations with SEBI being given the liberty to exercise their jurisdiction in all matters connected with issue of capital.[28] Why then does Section 149 (4) of the Act, rather than provide general guidance ('a listed company should appoint independent directors to its

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[24] T Risk Management - An essential facet of Corporate Goverate Governance by T.N.PANDEY, SEBI AND CORPORATE LAWS, July 17-July 23, 2006 PP, 27-38.

[25] Government of India, *Report: Expert Committee on Company Law* (Ministry of Corporate Affairs, 2005) Chapter II at para.19.

[26] Parliament of India, *21st Report: The Companies Bill 2009* (Standing Committee on Finance, 2010) Part 2, Chapter II at para.3.4.

[27] Parliament of India, 57th *Report: The Companies Bill 2011* (Standing Committee on Finance, 2012) Chapter IV at SN.19.

[28] Ibid.

Board') stipulate specifically that independent directors must make up one-third of the Board of a listed company? Or why does Section 197 of the Act rather than provide general guidance ('there should be limits on managerial remuneration in a public company') stipulate specifically that the remuneration of key personnel must not exceed eleven percent of the net profits? A plausible answer is that the provisions in a particular clause are the minimum requirements applicable to every company or class of companies referred to therein. A more compelling answer is that the MCA introduced these clauses because they were exercising their jurisdiction to regulate these matters as they were concerned with corporate governance.

The overlap and conflict of the Act with the listing agreement is a consequence of SEBI acting *ultra vires* by exceeding its designated jurisdiction with the tacit approval of the MCA. The question that must then be asked is why the MCA allows SEBI to regulate issues such as managerial remuneration among various other things that have little or nothing to do with the capital market. The MCA's defence is that SEBI has to play a central role in public access to capital issued by companies and must therefore have the necessary space to develop suitable frameworks in tune with the fluidity of the capital markets.[29] In their view, a sectoral regulator like SEBI may provide for more detailed or stringent provisions, not inconsistent with such provisions provided in the Act for sectoral companies under their jurisdiction. This view was endorsed by the Parliamentary Standing Committee on Finance who stated that the Government, while providing for minimum benchmarks in the Act, should allow sectoral regulators like SEBI to exercise their designated jurisdiction through a more detailed regulatory regime, to be decided by them according to

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[29] Supra note 26.

circumstances.[30] The question that must then be asked is can SEBI go outside their designated jurisdiction ("issues concerned with capital/securities market") to devise a regulatory regime for corporate governance in general on the basis that they must do so to keep pace with the ever changing capital/securities market. During consultations with the MCA SEBI suggested that it be given the jurisdiction to prescribe matters relating to corporate governance for listed companies. However, MCA rejected this request and decided that the core governing principles of corporate governance may be provided for in the Act itself.[31] Therefore, under company law, the simple answer to the question as to whether SEBI has jurisdiction over corporate governance is no.

CONCLUSION: THE NEED FOR ENABLING LEGISLATION

Unlike the United States, where the Securities Exchange Commission can point to the Sarbanes-Oxley Act, 2002 which specifically confers upon it the power to prescribe rules to implement corporate governance legislation, SEBI cannot point to a specific piece of legislation to impose corporate governance requirements on listed companies through Clause 49 of the listing agreement. The MCA has rejected the argument that listed companies should be liberated from corporate governance oversight by the State and only be subjected to the exclusive regulatory supervision of SEBI.[32] While the arguments for and against explicitly granting SEBI jurisdiction over corporate governance are beyond the scope of this paper, it has been demonstrated that SEBI already exercises significant regulatory authority on corporate governance matters. SEBI does so with the tacit support and backing of the MCA, as is evident from the first tranche of draft rules under the Act released by the MCA, wherein every

[30] Supra note 25 Part 1 at para.33.
[31] Supra note 11 at para 7.1.
[32] Supra note 26.

attempt has been made to ensure listed companies comply with the more stringent requirements of the listing agreement.[33] SEBI also has the backing of the Supreme Court, which reaffirmed this support in the recently concluded *Sahara*[34] case, and various institutional investors.[35] To ensure that SEBI does not continue to be a law unto itself Parliament must, in the interests of all stakeholders, especially listed companies, provide for enabling legislation on the basis of the United States' Sarbanes-Oxley model. This enabling legislation would give SEBI the necessary legal cloak to implement corporate governance legislation through the listing agreement. It is submitted that the time has come, in the words of the SEBI Chairman, for 'the Government to take a clear-cut jurisdiction decision'.[36]

[33] Supra note 15.
[34] Supra note 6.
[35] Confederation of Indian Industry and Institutional Investor Advisory Services, *CII-IIAS Institutional Investors Survey* (2012) http://www.iias.in/downloads/CII_IIAS_Institutional_Investor_Survey.pdf, visited on September 13, 2013.
[36] I. Dugal and A. Rukhaiyar, *Govt must take clear-cut call on jurisdiction of regulators: Sebi chief U K Sinha*, Financial Express, Mumbai, May 22, 2013. http://www.financialexpress.com/news/govt-must-take-clearcut-call-on-jurisdiction-of-regulators-sebi-chief-u-k-sinha/1118788/0 , visited on September 13, 2013.

CONTEMPORARY CHALLENGES OF GOVERNANCE IN PPP MODEL OF INFRASTRUCTURE PROJECTS

- Garima Tyagi & Itisha Gupta[1]

ABSTRACT

A modern trend these days for infrastructure development in India is that of Public-Private Partnership projects. The partnership aims to get the best of both worlds, i.e., the responsibility of the government and the resources and efficiency of the private sector. But somehow, even with the popularity of the concept, it has not proved to be as successful a model as it was intended to be. There are several challenges that these projects face which are reducing the viability of this model. But the limitations that are most common to PPP projects are that of good governance. The authors have tried to identify and analyse the contemporary challenges of governance that ultimately lead to the failure of such PPP projects. For these challenges, practicable solutions have also been provided which can help mitigate these challenges and eventually increase the success rate of PPP projects.

The failure of PPP projects is not incurable. With the right guidance and regulatory framework, the success rate of such projects can be increased drastically. What is required is a paradigm shift in how the government and private sector perceive each other. It is only with trust and open communication that a strong foundation base for PPP projects can be laid down.

INTRODUCTION

With the rapidly growing economies and the ever increasing population, nations are now facing what is being termed as an "infrastructure deficit".[2] This

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[1]The authors are 3rd year LL.B. students at National Law University, Jodhpur.

[2]United Nations Economic Commission for Europe, *Guidebook on Promoting Good Governance in Public- Private Partnerships,* p. 5,(2008) [hereinafter UNECE].

means that there is a dearth of properly-built roads, well-maintained transit system, schools, hospitals, recreational facilities, and water and sanitation networks. This is having an adverse impact on the standard of living of the people. The economic productivity of the society is deteriorating because of lack of infrastructural support. The Government, despite its best intentions, is finding it difficult to fulfil this infrastructure gap. Since these infrastructure projects are carried on a very large scale and have a long gestation period, tax base alone cannot satisfy the needs of such projects. Exorbitant costs of large, long-term infrastructure projects are restraining the government from undertaking new projects and implementing the old ones. The government is therefore looking for practicable alternatives to deal with this situation.

One of the alternatives that the government is applying in today's Indian scenario is forming Public-Private Partnerships ("PPP"). Private sector investment is a great source for obtaining huge amounts of funds for these infrastructure projects. Add to this, the benefit of major risk transfer to a private party, additional skills and expertise which helps in increasing the overall efficiency of such projects and the PPP Model option becomes the most viable one. Taking this into account, several measures are being implemented by the government to ensure that the private sector plays an essential role in the infrastructural growth and development of India.

The government through the Twelfth Five Year Plan (2012 – 2017) encourages private sector participation directly as well as through various forms of PPP, wherever desirable and feasible. In recent times, Dr. Manmohan Singh, the Prime Minster of India, in a bid to ramp up investor sentiment set an

investment target of Rs. 1.15 lakh crore in PPP projects across infrastructure sectors in rail, port and power for the period of next six months.[3]

There is an immediate need to go for PPP model of Infrastructure development and this need has been recognised by Government of India. But the fact remains that PPP investments have so far been only a small percentage of total investments and still a smaller percentage of the potential for such investments. There are apprehensions and there are failures. Recently, Delhi Airport Metro Express Private Limited ("DAMEPL"), controlled by Reliance Infrastructure and Delhi Metro Rail Corporation ("DMRC"), pulled out of its 30 year contract to operate and maintain the Airport Express Line, due to wrong demand forecasting under the policy framework.[4] Such failures and our deep rooted apprehensions about its success require a thorough look on the system of Governance of PPP projects in India. There is an urgent need to set up a system of Governance which improves the reliability of success of PPP projects and infuses fresh confidence in both public authorities and private investors to deliver the much needed infrastructure. The challenges in setting up such system of Governance have been discussed in this paper with focus on practical solutions for such challenges.

PUBLIC PRIVATE PARTNERSHIPS

PPP refer to innovative methods used by the public sector to contract with the private sector, who bring their capital and their ability to deliver projects on time and to budget, while the public sector retains the responsibility to provide these services to the public in a way that benefits the public and

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[3] *Targets for Next Six Months*, July 2, 2013, http://indiappp.com/Trends.php?Trends=227, visited on September 16, 2013.

[4] Line of warning: GovtMust Learn the Lessons of Delhi's Airport Express,*Business Standard*, New Delhi, July 2, 2013.

delivers economic development and an improvement in the quality of life.[5]

A World Bank report has declared that since 2006, India has received the maximum investment projects through PPP Model in the group of developing countries.[6]As of 31 March 2012, 390 PPP projects have been approved involving an investment of Rs. 3,05,010crore.[7]At the Central level, the National Highway Authority of India (NHAI) is the leading user of the PPP model. The Roadway sector contributes maximum to the PPP value in India (53.4%).[8]As each state has its discretion to promulgate legislations in the areas covered in the State List, several states have taken substantive steps to ensure that maximum PPP projects are awarded and then performed successfully within the state. Some of the major sectors that boast of successful PPP projects are as under:

National Highways

National Highway Development Project ("NHDP") is one of the largest road development programmes to be undertaken by a government in the world and involves widening, upgrading and rehabilitation of about 55,000 km, entailing an estimated investment of Rs. 3 lakh crore.[9]

This project began in the last decade and recognized the role of private sector in the country's infrastructure development. For this reason, NHDP is one of the very first PPP initiatives that is successfully running till date. One of the main reasons for the success of the NHDP is the Model Concession Agreement (MCA) that was drafted for PPP projects in the roadway sector. To clarify, the MCA is a framework which addresses issues such as unbundling of risks and

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[5]UNECE, *supra* note 2, at 1.

[6]Planning Commission of India, *TwelfthFive Year Plan (2012-2017): Faster, More Inclusive and Sustainable Growth*, (Government of India, 2013).

[7] *Id* at 18.

[8]FICCI and Ernst & Young, *Accelerating PPP in India*(2012).

[9]Price Waterhouse Coopers and The Associated Chamber of Commerce and Industry of India (ASSOCHAM), *The road ahead: Highways PPP in India*, at 21, (2012).

rewards, symmetry of obligation between the principal parties, equitable sharing of costs and obligations, and risk mitigation options under various scenarios including force majeure and termination, under transparent and fair procedures.[10]

Railways

A good example of PPP in Indian Railways is IRCTC-Ginger Rail YatriNiwas, New Delhi. This hotel was originally built in 1988 as part of Indian Railways' efforts to offer hotel rooms to the railway passengers at reasonable prices. It was then taken over by IRCTC in 2005 with a mandate to upgrade it on PPP basis.[11] Keeping its ultimate objective of world class service at affordable prices in view, IRCTC allotted the task of renovating and operating the hotel on PPP basis, for 15 years, on open tender basis. This task was taken up by M/s Roots Corporation Limited, a 100% subsidiary of The Indian Hotels Company Limited.[12]

Metro Express

The Delhi Airport Metro Express ("DAME") Line is a showcase of urban transport project from New Delhi to Dwarka, *via* Indira Gandhi International Airport. The Express Line was built through a Build–Operate–Transfer PPP Model, which was awarded to Reliance Infrastructure – Construcciones y Auxiliar de Ferrocarriles (CAF) Consortium in 2008 by DMRC for a period of 30 years. In this Consortium which is known as Delhi Airport Metro Express Private Limited (DAMEPL), CAF holds 5% equity, whereas Reliance

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[10] Government of India, *Guidelines for Investment in Road Sector*, 11, (Ministry of Shipping, Road Transport and Highways)

[11] Indian Railways Institute of Transport Management, Lucknow, *Study of PPP Project of Reliance Delhi Metro Airport Line*, (2013).

[12] *Id.*

Infrastructure holds the remaining 95%.[13]

Unfortunately, the DAME Project has not been able to reach its true potential. A successful example of PPP in metro system is yet to be established.

Airports

Delhi International Airport Limited (DIAL) is a PPP consortium between GMR Group, Airports Authority of India, Fraport and Malaysia Airports Holdings Berhad (MAHB). After following an international bidding process, the consortium was awarded a concession contract to operate, manage and develop the Indira Gandhi International Airport in 2006. The consortium finished Phase 1 of the project in 2010, where it completed the construction of the integrated passenger terminal (Terminal 3).[14] Completed in time for the 2010 Commonwealth Games, the US$2 billion development is a successful venture, and the consortium is now moving on to finish the subsequent phases of the project.

GOVERNANCE

Governance refers to the processes in government actions and how things are done, not just what is done. It covers the quality of institutions and their effectiveness in translating policy into successful implementation.[15]Following are the core principles or standards of good governance:[16]

(a) *Participation*: the degree of involvement of all stakeholders in the government policy that is to be implemented;

(b) *Decency*: the degree to which the formation and stewardship of the rules is

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[13]*Id.*

[14]Delhi International Airport (P) Limited, *About DIAL*, http://www.newdelhiairport.in/our-company.aspx, visited on September 16, 2013.

[15]UNECE, *supra* note 2, at 13.

[16]*Id.* at 13.

undertaken without harming or causing grievance to people;

(c) *Transparency*: the degree of clarity and openness with which decisions are made;

(d) *Accountability*: the extent to which political actors are responsible to society for what they say and do;

(e) *Fairness*: the degree to which rules apply equally to everyone in society; and

(f) *Efficiency*: the extent to which limited human and financial resources are applied without waste, delay or corruption or without prejudicing future generations.

On the basis of these standards, it can be adjudged whether there is good governance in the various areas of PPP project. A detailed analysis of governance in these areas and the challenges faced by the parties is done hereinafter.

PPP GOVERNANCE: CHALLENGES AND THEIR SOLUTIONS

The development of PPP projects takes place in three different phases.[17] The first phase is the stage where project policies are defined, legal viability of the projects are tested and project pipeline is identified. This is the initial stage of PPP where only the groundwork for establishment of PPP project is laid down. In the second phase, legislative reforms are introduced. This is the intermediary stage where the project pipeline is expanded, PPP units are established, new capital resources are identified and new guidelines for PPP are laid down. Steps are taken which facilitate better implementation of PPP projects. In the last stage, all impediments which can possibly hinder implementation of PPP projects are removed. In this stage a fully defined, comprehensive system is established for the project, PPP models are refined and reproduced. There is sophisticated risk allocation, and a thriving infrastructure

[17] *Id.*at 6.

investment market is created for funding the infrastructure process.[18] This is the final stage of PPP development where there is a strong institutional and legal framework to support PPP projects. Indeed, because of the strong base, a country in its third stage of PPP development can take up more sophisticated and complicated projects and can execute them with finesse and ease.

India currently is in its first stage of PPP development.[19]It faces a lot of institutional challenges. These 'institutions' consist of legal and regulatory frameworks and policy coherence; 'forums' where public and private sectors meet to smooth over the misunderstandings and frictions that can arise on specific projects etc. The challenge in PPPs in India is to develop the institutions, procedures and processes for effective PPP delivery. This can be defined as building 'governance'. If governments are to move up the maturity curve, they will have to devote considerable effort in improving governance.[20]

Some of the major challenges faced by the government during governance of PPP projects are discussed below:

Establishing an Effective Legal and Regulatory Framework

The entire legal and regulatory framework is very complex. It comprises of laws which are involved in a PPP project, the contract agreement signed between the parties, dispute resolution mechanisms, and authorities granting licenses and concessions.

Complex and insufficient laws

The legal framework of PPP projects involves a complex variety of laws from various fields like private contract law, company law, tax law, labour law, competition law, infrastructure sector laws, and many other laws. There are so

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[18]*Id.* at 7.
[19]UNECE, *supra* note 2, at 20-21.
[20]UNECE, *supra* note 2, at 9.

many procedures that they restrict the autonomy of the parties and lead to micromanagement of the project. For example, there are unnecessary laws and restrictions and procedures on land use and construction. Also, the investors are faced with the daunting task of obtaining numerous statutory clearances, licenses and approvals for the project, which in itself is a time-consuming and complex procedure. This happened in the Delhi Gurgaon Expressway project, where the parties had to obtain approvals from more than fifteen government bodies.

Current legal framework does not offer sufficient security and incentives to the investors

Most of the investors find insufficient legal protection offered to them in India as a deal-breaker. If the laws in the India do not offer security and protection to the investors, this has an adverse impact on the investments in PPP projects.

No independent regulatory authority in infrastructure sectors

The majority of infrastructure sectors in India like roads, railways, energy and many others do not have an independent regulatory authority.[21]Investors and users therefore, have no recourse to an independent regulator on matters such as dispute resolution, performance standards, consumer protection and competition.[22] They have to rely on the complex and varied laws rather than getting recourse at an independent uniform regulatory system.

Lack of effective dispute resolution mechanism.

Investors will be encouraged to participate in the PPP projects only when they think that the dispute resolution system is just and fair. A mechanism that

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[21] Planning Commission of India,„*Approach to Regulation of Infrastructure* (The Secretariat for the Commission on Infrastructure, 2008).

[22]*Id* at 2.

is unjust, corrupt and inefficient will only drive the potential investors away. Lack of a dispute resolution system means that foreign investors will be nervous about legal systems that they are unaware of and will be apprehensive about entering into contracts with the Indian government.

Even though it is preferable for the parties to include dispute resolution clauses in the concession agreement, they fail to do so; or if they do incorporate them into the agreement, they are vague and ambiguous. Thus, when a dispute arises, the parties have no option but to approach the court. This causes delay in the completion of the project, as the legal battle between the parties in the court goes on for years.

For example, in the DAME project, the contract terms did not clearly specify the dispute resolution mechanism. Therefore, when the dispute regarding contract renegotiation arose, the parties had no option other than to approach the court to resolve the matter. On the contrary, in the case of NHDP, the MCA clearly specified arbitration as a mechanism for dispute resolution. The agreement went on to prescribe the procedural law for the same in great detail.

The Solution

- There should be an overall comprehensive legal system with fewer, simpler and better laws[23]. This will not only encourage the investors to participate in PPP projects, but will also ensure that the entire PPP process is carried out smoothly and in the most efficient and effective manner.
- There must be a predictable and reliable framework for PPP in all laws in the India. This will help the investors in planning their investments and analysing their risks beforehand and create a sense of security in them.

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[23]UNECE, *supra* note 2, at 29.

- There is an urgent need for sector-specific independent regulatory authorities. In India, majority of infrastructure sectors like roads, railways, airport etc. do not have an independent regulatory authority.[24]This regulatory system has been implemented in several other countries, such as the United States of America, which has pioneered the creation of independent regulatory agencies whose core function is to create and improve legal and institutional structures of PPP.[25]
- Procedural laws should be simplified to facilitate easier and faster attainment of statutory clearances, licenses and concessions. Failure to obtain statutory clearances and licenses on time leads to increased project cost and reduced financial viability.
- In a bid to address infrastructure bottlenecks, the Planning Commission is planning to introduce a Dispute Resolution Bill which will propose to have fast-track mechanism for resolution of disputes in PPP projects covering all infrastructure sectors.[26]
- An effective system of contract management with the help of a Model Concession Agreement (MCA) can go a long way in resolving the contractual disputes.

1. ***Setting Clear National Policy on PPP: Objectives and Goals***

A PPP policy is needed to set a 'roadmap' for implementation. Without it, there will be no mechanism to enable aspirations to materialize into concrete projects. One of the essential components of good governance is the framing of a comprehensive and strong PPP policy.

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[24]S*upra* note 16, at 2.
[25]S*upra* note 16, at 9.
[26]Timsy Jaipuria, *Government Proposes Bill to Fast-Track Infrastructure PPP Dispute Resolution,* The Indian Express, July 3, 2013.

A PPP policy typically includes:[27]

- *PPP program objectives* – Why the government is pursuing a PPP program.
- *PPP program scope* –What types of projects will be pursued under the PPP policy.
- *Implementing principles* – How PPP projects will be implemented to ensure the PPP program meets it objectives. Transparency and Value for Money (VFM) are two important implementing principles in PPP policy.[28]

Absence of an overall PPP policy

Surprisingly, some governments nowadays undertake projects without an overall PPP policy and even if the policy is framed, it does not lay down the economic and social objectives of the consortium in crystal clear terms. It is also very rigid in nature, which does not prescribe achievable goals.

Lack of proper assistance

At the time of policy formation, the government in order to save costs takes the help of ill-equipped consultants. There are constraints on availability of technical data in several PPP projects. This leads to formulation of a flawed PPP policy.

For example, in the DAME project discussed earlier, the consultant made a miscalculation about the projected footfall for use of the Express Line. Where the projection was for 40,000 passengers per day, the actual traffic on an average was only 20,000 per day[29]. This eventually forced the concessionaire into tremendous losses, who then backed out of the contract.

Presence of optimum bias during policy formation

The PPP policy-making process often suffers from *"optimism*

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[27]PPIAF, *Public-Private Partnerships: Reference Guide*,70 (World Bank, 2012)
[28]*Id* at 70.
[29] Sudheer Pal Singh, What is wrong with PPP in India?, *Business Standard*, July 6, 2013

bias".[30]Within the policy, the benefits arising out of the project are often over-estimated and the costs are under-estimated. This leads to huge losses in the future.

Corruption in policy making

The policy making process is rife with corruption. This corruption is due to lack of transparency in project selection and is often motivated by political gains.

The Solution

- A PPP policy should be formulated with the consent of both the internal ministries as well as the external stakeholder. Further, it should inspire the confidence of the investor community and should set realistic goals.
- The policy should mandate efficient planning right from the inception of the project. This planning should include risk evaluation, financial evaluation and a thorough analysis of the overall requirements of the project.

  For example, in the Timarpur Integrated Solid Waste Management project, efforts were made on project preparation prior to the launch of the bid process. Detailed technical studies and reviews, financial evaluation, risk evaluation and regulatory and statutory approvals were undertaken at the project preparation stage itself. This ensured that the actual project development phase experienced as few limitations as possible.[31]
- The principle of *due diligence* should be made compulsory through policy. Due diligence refers to the investigation of a business or project prior to a

[30]*Id* at 27.
[31]Government of India, *Public Private Partnership Projects in India, Compendium of Case Studies* at 7, (Ministry of Finance, 2010).

signing of the contract and is generally associated with a reasonable standard of care. It also helps to assess the risks in a project. The policy framework should be drafted after investigation on the following, among other things:

- Legal and regulatory framework in the country.
- Relevant government agencies and their impact on the project,etc.

- The government should hire competent technical experts who are well-equipped to assist in policy formation. These consultants should be made accountable for their failures in proper policy making.

3. *Intelligent system of Risk Allocation*

PPP model encourages sharing of risks between the private and public parties. Given that such projects are taken up on such a large scale, public sector finds it very convenient to transfer majority of the risk to the private sector which in most of the cases is better suitedat managing it. However, indiscriminate assignment of risk to private partner may in itself be a big risk as has been seen in the recent DAME project, where the entire commercial risk was allocated to the private partner.

Dealing with identified and potential risks

The major types of risks involved in PPP infrastructure projects include construction risk (delays in construction),commercial risk (lower than expected demand for services produced by the project), operating risk (inefficiency in operation leading to higher operating cost), etc.[32]

Even after the risk has been identified, dealing with the identified risk proves to be a major challenge for the government. For example, the government finds it

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[32]UNESCAP, *Public-Private Partnerships in Infrastructure Development: An introduction to issues from different perspectives* at 53 (2007).

very difficult to calculate the definite commercial risk where the actual demand cannot be forecasted, especially in the transport sector.

Reluctance of Government to mitigate risk

It is advisable on part of the government to mitigate all potential risks involved in a project, but the government is often reluctant to mitigate those risks which have been allocated to the private sector. Moreover, even if the government decides to mitigate the risk, it faces certain challenges. For example, one of the forms of risk mitigation is where the government guarantees to shield the private sector from unforeseen risks. But here the private sector starts taking it for granted and is tempted to take these guarantees as an alternative to managing the risk themselves. In the absence of risk, the private sector loses its incentive to perform well and get a payback on its investment.

Improper allocation of risks between the parties

Many PPP projects often fail because the parties cannot agree on the allocation of risk, with each side trying to shift the risk to the other. Here, the government perceives the private sector to be most capable of managing risks and transfers most of the risk to the private sector. This is essentially wrong as risks should be allocated according to the nature and type of risk involved. For example, political and regulatory risks are more appropriate for the public sector, while commercial and operating risks are more suited to the private sector.[33]

Because of faulty risk allocation, the private sector often hesitates to become part of projects where it faces such a high amount of risk. Thus, the

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[33]UNESCAP, *A Guidebook on Public-Private Partnership in Infrastructure* at 39, (2011), [hereinafter UNESCAP]

participation of this sector declines even in the face of extremely profitable projects.

To sum up, the basic governance challenges in risk management are:

- Intelligent identification of all potential risks on the basis of due diligence,
- Setting appropriate risk mitigation measures by the government, and
- Judicious allocation of risk between the two partners.

The Solution

- In the planning stage itself, all the potential possible risks should be identified and made known to the private investors so that they can make an informed decision about the project.
- Risk should be divided between the public and private entities on the basis of capability of the party to manage that risk and the entire risk should not be transferred to one party. The significance of proper allocation of risk cannot be stressed enough.
- Contractual documentation should provide adequate protection to lenders against non-commercial risks related to force majeure, regulatory changes, contract termination etc.[34]
- Risk mitigation measures should be adopted to minimize the risk as much as possible. Guarantees and insurance against unforeseeable risks are probable methods of risk mitigation.
- To mitigate revenue risks, measures such as Viable Gap Funding (VGF) may be used. Under this scheme, a grant, one-time or deferred, is provided with the objective of making projects commercially viable. The funding can

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[34]Government of India, *National Public Private Partnership Policy*,(Ministry of Finance , 2011)

take various forms including capital grants, subordinated loans etc. A special cell within the Ministry of Finance manages the special fund, which receives annual budget allocations from the government. Implementing agencies can request funding support from the fund according to some established criteria[35].

4. ***Transparent and unambiguous system of PPP Procurement***

PPP procurement means procuring tenders by the Government from private investors for PPP projects. The basic aim of procurement is to select the best proposal which has the lowest project cost and also saves time. At the same time, competition needs to be encouraged.

PPP procurement under the regime of good governance must at all times fall true to three principles. They are:

- Transparency
- Neutrality and Fairness
- Non-Discriminatory

Lack of Transparency and Neutrality

Transparency refers to the degree to which information is open and available to all the participants in a project. But this transparency is lacking in the bidding process andaward allocation in PPP projects, especially with regards to the stakeholders who apply for tenders. Lack of transparency in PPP procurement ultimately leads to corruption in PPP projects.

Non-Discrimination in procurement

PPP procurement process generally tends to be discriminatory. The

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[35] *Supra* note 32 at 42.

process is marred with corruption which means that the government tends to favour one company over another. Also, sometimes, it's a practice that foreign companies are discriminated against. This prevents them from being part of an Indian project. There is also lack of adequate administrative procedure to encourage competitive tendering.

The Solution

- There is a need for independent institutions to ensure that the procurement process has been done in a fair and transparent manner. *Firstly*, an independent domestic tribunal should be present to hear the grievances of people who believe the discriminatory process to be arbitrary. *Secondly*, an independent monitoring authority – with powers to self-initiate investigations into the PPP procurement practices – can play an important role in monitoring the implementation of the rules by individual procuring entities. *Thirdly*, an independent auditor must be present to keep an unbiased audit of the entire PPP program.
- It should be ensured that there is transparency at every stage of tendering process *i.e.*, Request for tender preparation, advertisement for tenders, formulation of evaluation criteria, and tender evaluation.[36]
- Provisions must be laid down where discrimination, non-transparency and any other form of prejudice with regards to procurement of tenders would amount to criminal penalization. This will go a long way in curbing the practice of corruption in PPP projects.

5. ***Institutional Capacity Building: Need for Skills and Training***

[36]U.N. ECOSOC, Committee for Trade, Industry, and Enterprise Development, *Governance in Public Private Partnerships for Infrastructure Development*, at 22(2005)

Because of their complicated nature, PPP projects require skills and a level of expertise which is generally lacking in the public sector. Capacity building, therefore, refers to the establishment of new institutions and training of public officials to deal with PPP projects while at the same time taking the help of private expertise wherever required. The institutions which can assist in capacity-building for PPP projects are PPP Units, National Training Programmes, external advisors etc. The main areas in which development of skills are required include[37]

a. Project identification and structuring,

b. Economic and financial evaluation,

c. Risk assessment and management,

d. Value for money as a PPP project,

e. Project procurement, etc.

The government, especially in developing countries, is unable to acquire the much needed skills for PPP projects. The reasons range from insecurity of the public officials in taking help from private experts to paucity of funds with the public sector to organize proper training programmes for its officials. More often than not, the government also finds it extremely difficult to retain its recruited private experts in its employment as these experts find it difficult to adapt to norms of the public sector.

Moreover, there is lack of proper networking between the existing institutions (like PPP units, experts) which provide training to the public sector.

To sum up, the major challenges faced by the public sector during capacity building are:

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[37] *Supra* note 26, at 36.

- Inability to retain private experts, which provide guidance and training to public sector, in public employment.
- Lack of funds with the government to establish proper training programs for the public sector officials.
- Lack of initiative on the part of the government, especially in developing countries, to establish proper PPP units which incidentally are the most important institutions in developing and implementing PPP projects.

The Solution

- *Establishment of PPP Units* – PPP units are independent bodies which help in the overall planning, development, support and management of PPP projects. They are established at the national as well as the regional level.

  The National PPP Unit aims to reduce bid time and costs and to improve the quality of the PPP procurement process with standardized contracts and procedures, while ensuring national-level consistency. It consults with investors and communicates to line ministries their concerns regarding legal and institutional bottlenecks to the implementation of PPP projects.
- *PPP Training Programs* – The government may also consider developing PPP training programs for public officials in collaboration with national training and academic institutions.
- *External Advisors* – Capacity Building can be encouraged by hiring highly trained external advisors who can provide the necessary guidance to the public sector and fill in the skill gap.

CONCLUSION

PPP in infrastructure is a rapidly evolving concept in India. Over the

past decade, India has greatly encouraged private investment in PPP projects. This concept offers an excellent alternative to the infrastructural woes of a developing country like India. But PPP as a concept is yet to realize its full potential in our country. India is still in its infant stage of PPP. The reason for this is lack of an overall environment which is conducive to PPP growth. This makes implementation of PPP projects extremely difficult.

A major overhaul is required at each and every stage of PPP if it is to be a success in India. All the challenges which are faced during policy making, capacity building, procurement etc. will be overcome if principles of good governance are complied with at each and every stage of the implementation process.

Also, the entire approach of both the private and public players to PPP needs to undergo a major change. Both parties need to trust each other and work together to deliver public services to the society. In the end, it must not be forgotten that the last P in PPP stands for Partnership.

SEBI'S JURISDICTION ON CORPORATE GOVERNANCE IN INDIA: A CRITICAL ASSESSMENT

- Anand Swaroop Das and Anand Vardhan Narayan[1]

ABSTRACT

The concept of corporate governance has acquired tremendous significance in the modern day corporate law. The aftermath of big corporate scams like Satyam Computers scam, UTI etc called for proper and effective governance of companies to protect the interests of the shareholders and owners. SEBI and MCA act as gatekeepers of corporate governance in the country. However, over a period of 2 decades, the jurisdiction of SEBI has been undergoing myriad changes. This research paper seeks to analyze the jurisdiction of the Securities and Exchange Board of India with regards to corporate governance and make a critical assessment of the same. The highlight of the paper being the jurisdiction of SEBI, the authors would analyze the effectiveness of SEBI in ensuring corporate governance and how its jurisdiction has changed over the years ever since its inception in 1988. Recent judicial pronouncements and legislative efforts have attempted to find a midway to the conflict between SEBI and MCA. This paper analyzes the conflict in the light of SEBI's expanding jurisdiction. The authors of the paper are of the view that legislative wisdom should come into play whenever there is such a crisis and act accordingly.

INTRODUCTION

Corporate governance, like politics, concerns "who gets what, when and how"[2]. The concept of corporate governance has acquired tremendous significance in

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[1]Students of 3rd Year, B.A LL.B, National Law University, Odisha.

[2]Harold Lasswell,*Politics: Who Gets What, When, How* (5th ed. 1958), p.213.

modern day corporate law. Though, a fairly recent phenomenon in India, corporate governance is an indispensable factor in the corporate sector of the country. Since the corporate sector holds the key to the economy of the country, there must be certain mechanisms to ensure the effective governance in the sector. Following on from a period of economic downturn and social unrest in 1990-1, the Indian Government introduced a programme of reforms to open up the economy and encourage greater reliance on market mechanisms and less reliance on government[3]. The Securities and Exchange Board of India ("SEBI") was established to regulate the market of India and act as a gatekeeper to corporate governance in the country. Ever since its inception in 1992, SEBI has been instrumental in monitoring and strengthening the corporate governance norms in the country. With the manifold expansion of the corporate sector, increase in the number of Multi-National Companies etc, the jurisdiction of SEBI has also undergone certain major changes. This increasing jurisdiction of SEBI over the years has sparked off various debates and controversies. The latest development in this aspect has been the issue of a consultative paper by SEBI on Corporate Governance Norms in the country. Before venturing into the critical assessment of SEBI's jurisdiction on corporate governance, it is pertinent to understand the concept and the underlying principles of Corporate Governance.

CORPORATE GOVERNANCE: CONCEPT AND SCOPE

Corporate Governance basically necessitates a set of interpersonal relationships among a company's board of directors, shareholders, stakeholders and the auditors. It is on the basis of these relationships that the structure and the objectives of the company are determined and attained. Corporate Governance

[3] Christine A. Mallin, *Corporate Governance* (3rd ed. 2010), p.322.

relates to the "system by which companies are directed and controlled."[4] It represents the set of checks and balances within the corporate structure that helps create long-term value enhancement for stakeholders in a company[5]. Corporate Governance, thus involves, corporate responsibility (both social and environmental), transparency and accountability of operations and the members in charge of the operations etc. It results in the smoothening of the decision making process, better monitoring of risk, ensures integrity of reports and improves strategic thinking.

Corporate Governance was an alien concept to India for a long time. It came to the forefront during the 1990s[6] and qualified as a matter of law in 2000[7] when they were enforced as provisions prescribed by the SEBI. The guidelines of corporate governance have evolved since 1998 following the efforts of several committees appointed by the Securities and Exchange Board of India and the Ministry of Corporate Affairs- the two major gatekeepers of corporate governance in the country. Since the independence, great efforts have been made to strengthen the corporate governance norms amongst the listed companies of India. India's corporate governance norms are encapsulated in Clause 49 of the Listing Agreement.

The fiscal crisis of the 1990s prompted the Indian Government to respond with a number of economic reforms to liberalize the economy. These reforms ushered in a whole new era of corporate governance in India. The SEBI was established in the year 1992 to regulate the Indian Securities Market. SEBI's

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[4]Financial Reporting Council, *Report Of The Committee On The Financial Aspects Of Corporate Governance,* 2.5 (1992), available at http://www.ecgi.org/codes/documents/cadbury.pdf last visited on July 24, 2013.

[5] R.A.G. Monks and N. Minow, *Corporate Governance,* Blackwell Publishing (2nd ed. 2001), p.2.

[6] Confederation of Indian Industry, *Desirable Corporate Governance: A Code* (1998) available at http://www.nfcgindia.org/desirable_corporate_governance_cii.pdf.

[7] Securities and Exchange Board of India, *SMDRP/POLICY/CIR-10/2000* (Feb 21, 2000) available at http://www.sebi.gov.in/circulars/2000/CIR102000.html. visited on July 24, 2013.

reforms were instrumental in helping the tattered Indian economy to recover and lead to various other positive outcomes.

NEED FOR REGULATIONS AND REGULATORY FRAMEWORK IN INDIA

A pivotal part of Corporate Governance is the need to impose governance regulations through stock exchanges, supervisory authorities etc. Now, there are a few reasons as to why such regulations need to be imposed. Legally mandated rules are required to check excessive interference. Over-regulation of corporate bodies may lead to disruption of the functioning of such organizations and it will run counter to the principle of corporate governance. Another pertinent reason is that the owner and founder of the company may invoke inefficient rules owing to his inability to address the issues of the shareholders of the company. Such a situation calls for mandatory rules. In the absence of the aforementioned regulations, the stakeholders in the company, be it the shareholders or the owners, will be at a peril to incur losses. The need for regulations to ensure better corporate governance was felt strongly in the wake of numerous corporate scandals all over the world. Scams like Enron and WorldCom eroded the shareholders' trust in the entire corporate sector and affected the overall economy as well. India's markets are also weakly informative. Regulations will also check the management's attempts to alter rules to their own advantage which usually happens when the shareholding is dispersed widely in a company.

The SEBI, the Ministry of Corporate Affairs and Stock Exchanges together share the jurisdiction over markets. And such regulations from all the three centres sometimes overlap with each other. Multiple regulatory structures govern public listed companies. The MCA administers the Companies Act and is presently enforceable by the Company Law Board (CLB). Thus, MCA is the primary body and SEBI serves as the markets regulator ever since its inception.

The role of the SEBI is akin to that of the Securities and Exchange Commission (SEC) of the United States of America. The extent of SEBI's statutory authority has been a debatable topic of late and the issue of jurisdiction still remains a bone of contention between SEBI and MCA.

ROLE OF SEBI AS A WATCHDOG OF CORPORATE GOVERNANCE NORMS

The SEBI was established by the Central Government to regulate the stock markets of the country[8]. Initially in 1988, SEBI was established as an advisory body but then it was relegated to the status of market regulator by the Securities and Exchange Board of India Act of 1992[9].The Preamble of the SEBI Act[10], 1992 states: "An Act to provide for the establishment of a Board to protect the interests of investors in securitiesand to promote the development of, and to regulate, the securities market and for matters connectedtherewith or incidental thereto."

SEBI was distinguished as an independent statutory authority thereafter. SEBI was envisioned to serve as a "market oriented independent entity to regulate the securities market" akin to the role of the Securities and Exchange Commission (SEC) in the United States[11].

The ambit of SEBI's authority has been a matter of constant debate for long. The primary tasks with which SEBI has been charged include "regulating the business in stock exchanges and any other securities markets... prohibiting fraudulent and unfair trade practices relating to securities markets... prohibiting insider trading in securities ... [and] regulating substantial acquisition of shares

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[8]The Securities and Exchange Board of India Act, 1992

[9]*Ibid*.The SEBI Act of 1992 has since been amended three times: in 1995, 1999, and 2002. *See*Asian Corporate Governance Association, available at http://www.acga-asia.org/public/files/Kania-rep_032005.pdf.

[10]*Supra* note 6.

[11]Armour, J. and Lele, P. (2009), *Law, Finance, and Politics: The Case of India*, Law & Society Review, 43: 491–526.

and take-over of companies.."[12] The lack of SEBI's statutory authority during the 1990s fraud cases prompted the amendment of the SEBI Act in order to grant it sufficientpowers with respect to inspection, investigation, and enforcement, in linewith the powers granted to the SEC in the United States[13]. The rule-making authority of SEBI has been a controversial aspect. SEBI increased the responsibilities of the Listed Companies by significantly amending the Listing Agreement when it has been alleged that it lacked the said authority to do so.

Section 11 A of the SEBI Act grants SEBI the authority to "specify, by regulations, the matters relating toissue of capital, transfer of securities and other matters incidentalthereto ... and the manner in which such matters shall be disclosed by thecompanies."[14] Further, SEBI is granted broad authority to "specify therequirements for listing and transfer of securities and other mattersincidental thereto."' [15] This extensive authority of SEBI has led to its discord with MCA.

Under the Companies Act, MCA is responsible for regulating all registered companies.'[16] However, under the SEBI Act, all listed companies fall under the authority of SEBI as well[17].

SEBI has been instrumental in setting out corporate governance provisions to ensure a minimum standard of corporate governance among listed companies in India.

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[12]*Supra* note 8.
[13]Suchismita Bose, Securities Markets Regulations, 1 ICRA Bulletin: Money & Finance83, 106 (2005).
[14]*Supra* note 6.
[15]*Ibid.*
[16]*Govt. to Form A Panel to Reduce SEBI, DCA Overlap*, Indlaw News(June 2, 2003) available at http://news.indlaw.com/l DOD72FA584A040D8FDFB8FAF8315665. visited on July 24, 2013.
[17]*Ibid.*

SEBI'S INITIATIVE TO PROMOTE GOOD GOVERNANCE: WITH SPECIAL REFERENCE TO CLAUSE 49

The era of mid 1990s witnessed several major corporate governance initiatives. In 1998, Confederation of Indian Industry (CII) came up with the first voluntary code of corporate governance. In this regard, CII published '*Desirable Corporate Governance in India'*- A Code[18] and a number of forward-looking companies took its recommendation on board. However, it was observed that many companies still had poor governance practices.

As good governance has always been high on the priority list of SEBI, in the year 1999 it constituted a committee on corporate governance under the chairmanship of Shri Kumar Mangalam Birla.[19] The report submitted by the committee can be considered as the first formal and comprehensive attempt to evolve a 'Code of Corporate Governance', in the context of prevailing conditions of governance in Indian companies, as well as the state of capital markets.[20] The report emphasized the importance of corporate governance for future growth of the capital market and the economy. SEBI adopted the recommendation of this first committee and introduced unprecedented corporate governance reforms via Clause 49 of the Listing Agreement[21] of Stock Exchanges. By way of this Listing Agreement, the Stock Exchange, on behalf of SEBI, ensures that the Companies are adhering to good corporate governance practices. It is to be noted that the whole Listing Agreement is based on the concept of Corporate Governance. However, clause 49 specifically deals with Corporate Governance. Clause 49, which has been described as a

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[18] *Supra* note 7

[19] *Report of the Kumar Mangalam Birla Committee on Corporate Governance* available at http://web.sebi.gov.in/commreport/corpgov.html visited on July 24, 2013.

[20] *Ibid.*

[21] The Listing Agreement with stock exchanges defines the rules and processes that companies must follow in order to remain listed companies on an Indian stock exchange.

"watershed event in Indian corporate governance," established a number of corporate governance requirements with a focus on corporate boards and disclosure to shareholders."[22]

After the existence of this clause for two years a committee under the leadership of Mr. Narayana Murthy[23] was set up by SEBI for evaluation of the existing practice and to amend the same if needed. The Murthy Committee, after deliberation and discussion submitted its report on corporate governance norms but owing to widespread protest among various stakeholders, this committee again met to reconsider their draft. The committee, thereafter, considerably revised the earlier recommendations and the same was notified by SEBI on 29th October, 2004. Some of the major recommendations of the committee was primarily related to risk management, audit committees and audit qualification, proceeds from initial public offerings ("IPO"), independent directors, directorships and director compensation, codes of conduct and financial disclosures The revised clause 49 superseded all the earlier circulars on the subject and became effective for listed companies from January 01, 2006. It became applicable to the entities seeking listing for the first time and for existing listed entities having a paid up share 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.[24]

Clause 49 of the Equity Listing Agreement consists of mandatory as well as

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[22]Black, B. S. and Khanna, V. S. (2007), Can Corporate Governance Reforms Increase Firm Market Values? Event Study Evidence from India. Journal of Empirical Legal Studies, 4: 749–796.

[23] SEBI, *Report of the SEBI Committee on Corporate Governance* available at http://business.gov.in/outerwin.php?id=http://www.sebi.gov.in/commreport/corpgov.pdf. visited on July 24, 2013.

[24] SEBI, Consultative Paper On Review Of Corporate Governance Norms In India available at http://www.sebi.gov.in/cms/sebi_data/attachdocs/1357290354602.pdf. visited on July 24, 2013.

non mandatory provisions[25]. Some of the essential mandatory provision pertains to composition of Board and its procedure; independent director; composition and role of audit committee; provision related to subsidiary committee; disclosure by the companies to the audit committee; board and shareholders; quarterly report on corporate governance; annual compliance report. The objective behind amending clause 49 by SEBI was to strengthen the good governance norms in a more efficient way. Certain terms were added and defined in clause 49 to make the picture clearer. For instance, the word "material" was inserted before supplier, in Explanation (i) (e) to Clause I.A.

Regarding the aspect of composition of board, the revised clause has prescribed six tests which a non-executive director needs to fulfil to qualify as an independent director. Also, the expression 'independent director' has been expanded in the new amended clause. The revised clause 49 requires the Independent Director to periodically review legal compliance reports prepared by the company and any steps taken by the company to cure any taint. It limits the term of the office of the non-executive director and provides that a person shall be eligible for the office of non-executive director so long as the term of office does not exceed nine years in three terms of three years each, running continuously.[26] One important aspect of the revised clause 49 deals with audit committee. There is a provision which mandate the audit committee to review financial statements and draft audit report, including quarterly / half-yearly financial information, management discussion.

As per one of the non-mandatory provision of clause 49, there should be a separate section on Corporate Governance in the Annual Reports of listed

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[25] *Ibid.*

[26] Maheshwari and Co, *An analysis of revised clause 49 of the listing agreement* available athttp://www.maheshwariandco.com/repository/articles/downloads/clause49.pdf. visited on July 24, 2013.

companies, with detailed compliance report on Corporate Governance. Another notable feature of clause 49 is with respect to whistle blower. It calls for a mechanism for employees to report to the management their concerns about unethical behaviour, actual or suspected fraud or violation of the company's code of conduct or ethics policy.[27]

SEBI'S GROWING JURISDICTION: A CRITICAL ANALYSIS

1) SAHARA V SEBI: JURISDICTION OF SEBI OVER UNLISTED COMPANIES

The issue of jurisdiction of SEBI over listed companies hasarisen on several occasions in the past. There have been various cases where the courts have discussed the power of SEBI to control and regulate unlisted companies for protection of investors' interest[28] but they all remained unsettled until the recent Supreme Court's judgment in*Sahara India Real Estate Corporation Limited and others* v. *Securities and Exchange Board of India and Another*[29].The Supreme Court passed a landmark judgment emphasizing on investor protection and role of SEBI as investors' protector. This case settled the debate on jurisdiction of the SEBI and applicability of SEBI Act, 1992 to unlisted companies.

Sahara India Real Estate Corporation Limited and Sahara Housing Investment Corporation Limited were the companies controlled by Sahara group. The Saharas' raised funds through unsecured 'Optionally Fully Convertible

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[27]Clause 49 of Listing Agreement, available at http://www.nseindia.com/getting_listed/content/clause_49.pdf. visited on July 24, 2013.

[28]*Vijaya Finance Corporation Ltd.* v. *Peerless General Finance*, (2006) 129 Comp Case 733 (CLB); *See* also *MCX Stock Exchange Limited* v. *Securities and Exchange Board of India*, (2011) 8 Comp LJ 174 (Bom).

[29]*Sahara India Real Estate Corporation Limited and others* v. *Securities and Exchange Board of India and Another*,
2012 Indlaw SC 272.

Debentures'[30] (OFCDs) by way of private placement without giving any advertisement to general public. The Sahara group circulated an information memorandum/red herring prospectus with the Registrar of Companies but no documents with SEBI, on the view that the issue of share is purely a 'private placement' The maximum limit prescribed under Companies Act, 1956, under section 67(3), is 49 offerees, beyond which the offer would be a public offer.

Therefore, SEBI held those OFCDs to be a public issue and in this scenario, Sahara did not comply with the requirements applicable to the public offerings of securities. Thereby, SEBI passed an order dated 23rd June, 2011 directing both the companies to refund the money so collected to the investors. Sahara preferred an appeal before Securities Appellate Tribunal which was subsequently rejected and thereafter Sahara filed an appeal before the Supreme Court against the order passed by SAT. It was contended by Sahara that offer was a private placement of its securities to friends, relatives, etc and so no jurisdiction can be exercised by SEBI. On the other hand, SEBI contended that the offer was made to more than 50 persons and by virtue of Section 67(3), this offer was deemed to be public offer and as per the SEBI DIP Guidelines, 2000, SEBI had the jurisdiction over such offer. The Supreme Court dealt with several issues in its judgment including, inter alia, as to whether the issue of OFCDs to millions of persons who subscribed to the issue is a Private Placement or otherwise. After examining the provision of the Companies Act and SEBI Act, the Court held Section 67(3) specifically stated that when any security is offered to more than 50 persons then it will bedeemed to be a public offer and therefore SEBI will enjoy jurisdiction in this matter. It was also contended by Sahara that under

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[30] An instrument that does not yield interest in the initial period after which option is given to the holder of FCDs to apply for equity at a "premium" for which no additional amount needs to be paid.

Section 55Aof the Companies Act, SEBI had jurisdiction only over such companies that are either listed or intending to list. However, Supreme Court rejected this argument and it went on to hold that although the intention of the companies was to make the issue of OFCDs look like a private placement, it ceases to be so when such securities are offered to more than 50 persons.

This judgment is certainly a landmark judgment as it vests SEBI with innumerable power to investigate into any matter concerning the interest of the investor even if it pertains to unlisted companies. Also, this judgment clarifies significant points of law and it removes the grey area related jurisdiction of SEBI over unlisted companies.

2) CONSULTATIVE PAPER ON THE REVIEW OF CORPORATE GOVERNANCE NORMS

In the wake of the much debated Companies Bill, 2012 and with a purpose to align with its provisions, the SEBI on 4thJanuary, 2013 came out with a consultative paper on the review of corporate governance norms in India. The paper's suggestions have the potential to revolutionize the jurisdiction of SEBI with regard to the Corporate Governance Scenario in the country today.

In the paper, the SEBI has *inter alia* suggested measures like compulsory whistle-blower disclosure and protection mechanisms, rationalisation of CEO pay packages, complying with small investors for their benefit, more powers for the minority shareholders, adoption of diversity of thought, knowledge, perspective, gender etc by companies and implementation of an orderly succession planning. The SEBI has also stressed on the adoption of a particular corporate culture and values according to which the members will conduct themselves. There was also a mention of minimizing the adoption of policies which require

unnecessary risks and to ensure a risk management plan for that matter.

For better enforcement, the SEBI has stated that the provisions of the Listing Agreement are to be converted into regulations. And non-compliance of corporate governance norms will attract hefty penalties. The aforementioned compliance of such norms by the companies will be monitored by credit rating agencies, stock exchanges and SEBI. The major highlights of the consultative paper are dealt with below.

The consultative paper emphasized more on the directors of the companies by including many provisions which directly address and affect the directors. Some of the pertinent provisions relating to the directors are the appointment of independent directors by minority shareholders[31], assigning specific duties and responsibilities to Independent and Non-executive Directors, mandating maximum tenure for independent director to be two consecutive terms of 5 years in line with Companies Bill[32], requiring Independent directors to disclose reasons of their resignation[33], clarity on liabilities and on remuneration of independent directors[34], performance evaluation of independent director[35], calling for separate meetings of Independent Directors at least once in a year[36] and the maximum number of public companies in which an individual may serve as an Independent Director should be restricted to seven.

Other major highlights of the consultative paper are the separation of the position of Chairman and that of the Managing Director / CEO[37] to clearly demarcate their positions and avoid clashing of duties, framing of a risk

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[31] SEBI, *Consultative Paper on the Review of Corporate Governance Norms in India, Securities and Exchange Board of India*, 11 (2013).
[32]*Id.* at. 16.
[33]*Ibid.*
[34]*Id.* at. 17.
[35]*Id.* at. 18.
[36]*Id.* at. 19.
[37]*Id.* at. 20.

management plan, its compulsory monitoring and reviewing by a Board/Board Committee and the disclosure thereof to the shareholders at periodic intervals (preferably on annual basis)[38], making Whistle Blower Mechanism a compulsory requirement[39] to ensure more and better transparency in the administration, measures for preventing abuse of related Party Transactions[40], laying down of specific fiduciary responsibilities of controlling shareholders, mandating relationship agreement between the company and the controlling shareholder specifying the duties and responsibilities of controlling shareholders[41], provision for regulatory support to class action suits[42] and enforcement for non-compliance of Corporate Governance Norms[43] which is a very apposite insertion considering the unsuccessful compliance of those norms.

3) THE COMPANIES ACT, 2013

The passing of the Companies Bill, 2012 in both the houses of the Parliament was followed by the Hon'ble President's assent on 29th August, 2013. It was published in the official gazette on 30th August, 2013 and thus, finally becoming the Companies Act, 2013[44].

The concept of Board independence has been taken to a whole new level under the Companies Act, 2013 to ensure better corporate governance. Some of the very primary provisions concerning the directors in the Companies Act, 2013 are the inclusion of independent director in the Corporate Social Responsibility

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[38] *Id.* at. 21.
[39] *Id.* at. 23.
[40] SEBI, *Supra* note 32 at 29.
[41] *Ibid.*
[42] *Id.* at. 31.
[43] *Id.* at. 35.
[44] The Companies Act, 2013 (No. 18 of 2013)

Committee[45], independent directors in listen companies[46], ratification of Board meeting by at least one independent director[47], compulsory disclosure of interests[48] etc. Thus, a lot of leverage has been given to the independent directors keeping in view the norms of Corporate Governance.

The SEBI, in the new Companies Act, 2013 has undisputed jurisdiction over any company, listed or unlisted, which makes an offer to allot or invites subscription, or allots, or enters into an agreement to allot, securities to 50 or such higher number as may be prescribed, to make the same an 'offer to the public' and make provisions to govern such companies. The ambiguity regarding the term 'private placement' and 'public offer' has been clarified in the Act[49]. SEBI also received powers to regulate issue and transfer of securities and non-payment of dividend by listed companies and those companies which intend to get their securities listed on any recognized stock exchange in India[50]. The Central Government can also delegate powers to enforce provisions relating to insider trading and forward dealing to SEBI and the SEBI shall have the power to authorize an officer to file complaint in a court of competent jurisdiction[51].

Other such powers prescribed to SEBI under Companies Act, 2013 are in relation to the dissenting shareholders in case of variation of terms of contracts and objects in prospectus[52], in filing a shelf prospectus, the guidelines of SEBI have to be followed[53] and also in case of sweat equity shares[54]. SEBI also has

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[45]The Companies Act, 2013, § 135(1).
[46]The Companies Act, 2013, § 149(4).
[47]The Companies Act, 2013, § 173.
[48]The Companies Act, 2013, § 149(6).
[49]The Companies Act, 2013, § 23(1).
[50]The Companies Act, 2013, § 24(1).
[51]The Companies Act, 2013, § 458(1).
[52]The Companies Act, 2013, § 27(2).
[53]The Companies Act, 2013, § 31(1).
[54]The Companies Act, 2013, § 54(1).

powers of regulation in case of minority shareholders[55]. Power of SEBI can also be inferred from the provision which talks about the barring of a company limited by shares to issue irredeemable preference shares[56].

The Companies Act, 2013 comes as a welcome change for various auditors[57], investors and stakeholders bringing about reforms in enforcement measures and mandating the increase of transparency and accountability. The protection of investors and social welfare are kept at a high pedestal. Corporate governance norms have been strengthened with the provisions monitoring the ethical activities of the directors and other members of the company.

4) THE SECURITIES LAW (AMENDMENT) ORDINANCE, 2013: THE WAY FORWARD

The Government in order to enhance the power and jurisdiction of SEBI brought a The Securities Law (Amendment) Ordinance, 2013[58] which amended certain provisions of the SEBI Act and other related acts. This amendment has given wide powers to SEBI to investigate a matter. For instance, Section 11(2) (ia) of the SEBI Act has been amended to authorize SEBI to call for any information or records from any *person* including bank or any other authority or board or corporation, which shall be required in respect of any investigation or inquiry by SEBI.[59] Also, as per this ordinance, this power shall be with effective

[55]The Companies Act, 2013, § 236(9)(b).
[56]The Companies Act, 2013, § 55(1).
[57]The Companies Act, 2013, § 143(1).
[58] The Securities And Exchange Board Of India (Amendment) Bill, 2013 available at http://www.prsindia.org/uploads/media/SEBI%20(A)%20Bill,%202013/SEBI%20passed%20by%20RS.pdf. visited on July 24, 2013.
[59]*Report of Press Information Bureau*, Government of India (18th July, 2013) available at http://pib.nic.in/newsite/erelease.aspx?relid=97305 visited on July 24, 2013.

with retrospective effectfrom March 6, 1998. With numerous technological advancements, the need of the hour was to confer additional power on SEBI to bring perpetrators to book. In this regard, an amendment has been brought in Section 11(c) (8) of SEBI Act to confer SEBI the power to search any building, vessel, aircraft or break open the lock of any door, safe. Moreover, SEBI has also been given the power to seize any books or accounts, place marks of identification and record on oath the statement of any person. Further, section 11(c)(10) of SEBI Act has also been amended to allow the investigating authority to return the documents or records seized without intimation to Magistrate of such return.[60]

Owing to the numerous ways of fund-raising activity, SEBI receives complain against unapproved fund raising activities of certain companies. Section 11AA of the SEBI Act lays down grounds for any scheme to qualify for Collective Investment Scheme (CIS). To effectively tackle the above mentioned problem, a deeming provision has been added whereby any pooling of funds under any scheme of arrangement involving a corpus of Rs. 100 crore or more and not registered with SEBI, shall also be taken to be a CIS. This will bring chit funds having corpus of more than Rs. 100 crores under the purview of SEBI also, which according to section 11AA are exempt from SEBI exercising its jurisdiction.[61] Before this ordinance, for any scheme or arrangement to qualify as CIS it must necessarily have to be offered by the company. But after the passing of this ordinance, even schemes or arrangement offered by *persons* can qualify as

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[60] Nivedita Shankar, *Securities Laws (Amendment) Ordinance, 2013 gives more teeth to SEBI*, available athttps://india-financing.com/Securities_Laws_(Amendment)_Ordinance_2013_gives_more_teeth_to_SEBI.pdf visited on July 24, 2013.

[61] *Supra* note 59.

a CIS. In other words, any company or even an LLP which offers such schemes can qualify as a CIS and be regulated by SEBI.[62]

Another notable feature of this amendment has been to introduce Section 26A in SEBI Act and Section 19-IA in SCRA Act, 1996 to allow constitution of Special Courts for speedy trial of offences. The work of the Legislature however, does not stop here. Thus, there is willingness to amend this ordinance again. Recently, there was news that the Govt can re-promulgate this ordinance to give more extensive power to SEBI[63]. This will be done especially to empower SEBI to crack down on ponzi schemes[64].

CONCLUSION

While the debate regarding the jurisdiction of SEBI continues, the role of SEBI still remains significant in the corporate sector today. As the paper has analyzed that the increasing jurisdiction of SEBI has caused a lot of hue and cry, but still, the fact remains that SEBI has a major role to play as the market regulator. Failure to do so will amount to wilful neglect of duty. With the expansion of jurisdiction of SEBI over the years, the issue of jurisdictional conflict between SEBI and MCA will remain a bone of contention. Being a young and amateur organization, SEBI will always find it difficult to regulate theolder market entities in the corporate world like share brokerages etc. This problem came into limelight in the recently concluded Sahara-SEBI case. As the Legislature has always come to the rescue in such cases, recent legislative initiative in the form of Security Law Amendment Ordinance, 2013 seems to have the potential in

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[62] *Ibid.*

[63] *Govt may re-promulgate ordinance giving more powers to SEBI*, Economics Times, (September 9, 2013) available athttp://articles.economictimes.indiatimes.com/2013-09-09/news/41903646_1_ponzi-schemes-sebi-chairman-securities-market. visited on July 24, 2013.

[64] A Ponzi scheme is a fraudulent investment operation that pays returns to its investors from their own money or the money paid by subsequent investors, rather than from profit earned by the individual or organization running the operation.

tackling such issues.

However, it is very pertinent to note here that SEBI cannot go beyond the boundaries of law while carrying out its functions. SEBI, even with its jurisdictional expansion and powers cannot act arbitrarily by taking the law into its own hands.