ISSN No. 0976-0369 January 2023

JOURNAL ON GOVERNANCE

Volume V Issue 2

Changing Dynamics of Corporate Law & Governance: Steering towards Transparency & Accountability in the Indian Scenario

A National Law University Jodhpur Publication

JOURNAL ON GOVERNANCE

(SPECIAL EDITION ON CORPORATE LAW AND GOVERNANCE)

VOLUME V ISSUE 2

JANUARY 2023

The Journal on Governance (also known as 'Journal on Corporate Law and Governance') is published by the Centre for Corporate Governance at National Law University, Jodhpur.

The Centre publishes material on business and commercial laws of interest to the legal profession with the endeavour of serving as guidance in navigating complex legal issues. All rights reserved. No article or part thereof published herein may be reproduced without the prior permission of the Centre. For all matters concerning rights and permissions, please contact us at journal.governance@gmail.com.

The views expressed in the articles published in this Volume of the Journal on Corporate Law and Governance are those of the authors and in no way do they reflect the opinion of the Journal on Corporate Law and Governance, its editors, or the National Law University, Jodhpur. Every effort has been taken to ensure that no mistakes/ errors have crept in this journal. Any mistake, error or discrepancies therefore are inadvertent.

Published by:

The Registrar,

National Law University, Jodhpur

NH-65, Mandore, Jodhpur – 3424304

VOLUME 5 ISSUE 2

Journal on Governance

PATRON

Prof. (Dr.) Poonam Pradhan Saxena
Vice Chancellor

CHIEF EDITOR

Dr. Manoj Kumar Singh
Associate Prof., National Law University, Jodhpur

STUDENT EDITORIAL BOARD

EDITORS-IN-CHIEF

Shreya Rajasekaran *Vedaant S Agarwal*

EXECUTIVE EDITOR

Saurav Thampan

MANAGING EDITOR

Ojasav Chitranshi

SENIOR CONTENT EDITORS

Abhigya Singh *Avni Kumar Srivastava* *Deesha Reshmi* *Parth Goyal*

ASSOCIATE EDITORS

Ainesh Chaudhary *Bhuvnesh Kumar* *Chirag Chachad* *Lakshya Sharma*
Mohak Agarwal

COPY EDITORS

Akrati Trivedi *Anandita Anand* *Kriti Kabra*

Nandini Babbar *Paridhi Gupta* *Piyush Senapati*

TECHNICAL EDITOR

Rohit Meena

FOREWORD

The new colour is 'green' which is very dominant in all human affairs and corporate affairs are not an exception to it. Sustainable investing has attained normative character and India is the flag runner of peace and prosperity being the fifth-largest economy. Corporate financing is needed on an unprecedented scale for market calibration. The profit to the public approach of corporations reflects compliance with ESG norms. Green goods, green finance and green infrastructure in pursuance of commitments to deep de-carbonization is the need of the hour. By 2030, we need 30 trillion USD for replacing the old and make new infrastructure and India alone needs 2.5 trillion USD. Sustainable investing based on ESG disclosures will be needed.

In a post-pandemic scenario, Indian regulators are trying hard to create an ecosystem for ESG norms & disclosures. Many initiatives have been taken in the last two years. Since 1992, the central theme of corporate governance has been 'transparency and accountability' but now, it has shifted to ESG due to the ageing of Indian corporations and its robust presence in the world order. Creating ESG rating ecosystems, attracting investment based on such disclosures which are sustainable, transition to clean technologies without loss of jobs and on cheap rates, making products which are green, including diversity on board and workforce, protection and promotion of human rights, organized and systematic business model, egalitarian orderliness in the corporate hierarchy are some of the most challenging and daunting tasks before corporate houses of India and the world which are severally affected due to pandemic and supply chain disruptions. Commitment to CoP 26 and 27 is to be kept in mind and Indian companies have to change for both the better and bigger.

For Volume V, Issue 2 of the Journal on Corporate Law and Governance, we have carefully chosen articles and research papers to bring out the best to our avid readers for adding value. The first article,

"**Securities Appellate Tribunal Jettisons Corporate Governance Norms in Its Decision in Terrascope Ventures**" deals with an intricate issue. Compliances with norms are becoming tough which sometimes makes everything very tiring. The SAT's decision in Terrascope Ventures decided that all invalid non-compliance acts or omissions can be legalized ex-post facto by ratifying the same via special resolutions. This decision will open Pandora's box in prosecuting the officers of the company.

The second article "**The Great Indian IPO Rush: Changes in Lock-in Periods and Effect on Retail Individual Investors**" highlights the issues pertaining to lock-in periods in IPO. In a post-pandemic world, the IPOs are lined up like never before and some of the biggest flotations have happened like Paytm, LIC, Global Heath, etc. However, the volatility of market prices of shares has been a cause of concern and most of the shares are running lower than their IPO price; therefore, maintaining the buoyancy of the market has been very challenging. The change in the lock-in period will have its own repercussions.

The third article "**Need for Convergence in Structural Organization of The Boards in Public Companies in India**" deals with a very important issue of corporate governance in India. Since Solomon's case, we have witnessed that the same promoters are directors and managing directors and corporations & companies have turned out to be perpetual business dynasties where succession happens mostly from the family of promoters which is highly against the idea of shareholder's democracy in a public company governed by majoritarian governance. Separation of ownership with management is an innate feature of separate corporate personalities. But handing over the baton of business to family even if they are incompetent ruins the companies. An offshoot of ESG is better succession planning of boards and diversification of boards to enhance efficiency of boards. Correction of structural organization is the most challenging aspect and needs to be addressed.

The fourth article "**Short Termism in India: Towards a Sustainable Corporate Governance Model**" provides for long-term and short-term management of companies. Short-term governance of companies is a profit-oriented approach with is inextricably interlinked with long-term corporate governance. The woes, miseries, and maladies of short-termism are detailed in the article.

The fifth article is "**Circle among Square: Comparatively Analysing the Role and Need for Independent Director in India with Singapore**". In older times, bringing dissent on board via independent directors who can dare to oppose the mighty promoters having controlling shares was the practice. Blending, of an outsider with insider directors to bring transparency and accountability, was done. With the Companies Act, 2013 IDs were given statutory recognition and a robust ecosystem of training of IDs with IICA. This paper is making a comparative analysis of the IDs of India with Singapore. The exodus of IDs in recent times has been a cause of concern. This paper analyses the Singaporean Model and makes it a comparative appraisal with India to plug in the loopholes.

The sixth article "**Exploring of Lacuna of Leaving the Closet Insider, Outside the Scope of Insider Trading**", deals with insider trading. PIT Regulations have prohibited insider trading. The case of Rajat Gupta has been an eye-opener for the world. Prosecuting PACs for insider trading based on the passing of UPSI has always been a cause of concern. Busting the meeting of mind with cogent evidence from corporate prosecuting agencies is a hard nut to crack. This article deals with drawbacks, lacunas, and gaps in the prosecution regime.

In the modern world, companies are being regulated and compelled to comply with environmental, social, and governance (ESG) norms. Today, companies are also required to attract sustainable financing, maintain egalitarian order, inclusive governance, diversity of the board, and recognition & enforcement of human rights. Gross violations of human

rights in companies of all stakeholders like promoters, directors, shareholders, workers, and consumers, are reported from every corner of the world. Sustainable financing of companies, green products, and green infrastructure is to be provided for all commitments taken at CoP 26, and CoP 27 for deep de-carbonization in pursuance of climate change mitigation. Sustainable business, goods, and services are now the thing. Environmentally hazardous products and services are passé. Engendering boards and recruiting human resources in corporate houses must be devoid of gender and racial discrimination. Female CXOs and female entrepreneurship must be encouraged.

India is passing through a very crucial transition phase as the whole labour jurisprudence is to be put upside down by new labour codes which are a product of eccentric market forces. The whole consumer jurisprudence is changed by the new Consumer Protection Act, 2019 wherein the 'Product Liability Regime' and a bundle of consumer rights have been identified which are putting a lot of pressure on corporate houses to manufacture and sell goods and services to end consumer suited to the new legislative framework. This paper aims to identify the interplay of human rights in the new ESG regime in corporate governance of India and discuss the maladies and suggest remedies for the same.

We, the editorial team firmly hope & believe that the articles in this Issue will invoke debate, discussions, and deliberations in all our avid readers for the betterment of sustainable businesses.

Dr. Manoj Kumar Singh
Chief Editor, Journal on Governance
Associate Prof., National Law University, Jodhpur

THIS PAGE HAS BEEN LEFT BLANK INTENTIONALLY

TABLE OF CONTENTS

SAT'S ORDER ON TERRASCOPE VENTURES: DEPARTURE FROM REQUISITE CORPORATE GOVERNANCE NORMS?
Hartej Singh Kochher……………………………………………………1

THE GREAT INDIAN IPO RUSH: CHANGES IN LOCK-IN-PERIODS AND ITS EFFECT ON RETAIL INDIVIDUAL INVESTORS
Anubhav Jaiswal & Priya Kataria……………………………………...20

NEED FOR CONVERGENCE IN STRUCTURAL ORGANIZATIONS OF BOARDS IN PUBLIC COMPANIES IN INDIA
Ashwin Bala Someshwerar…………………………………………...37

SHORT-TERMISM IN INDIA: TOWARDS A SUSTAINABLE CORPORATE GOVERNANCE MODEL
Abhinav Gupta & Madeeha Arshad……………………………………55

CIRCLE AMONG SQUARE: COMPARATIVELY ANALYSING THE ROLE AND NEED FOR INDEPENDENT DIRECTOR IN INDIA WITH SINGAPORE
Sriranjani R…………………………………………………………..98

EXPLORING THE LACUNA OF LEAVING THE CLOSEST INSIDER, OUTSIDE THE SCOPE OF INSIDER TRADING
Prajwal Totla…………………………………………………………...117

SAT'S ORDER ON TERRASCOPE VENTURES: DEPARTURE FROM REQUISITE CORPORATE GOVERNANCE NORMS?

Prof. Hartej Singh Kochher[*]

ABSTRACT

The article critiques the order of the Securities Appellate Tribunal in the case of Terrascope Ventures Limited. The order absolved the company and its two directors of all regulatory and statutory violations on the grounds that a special resolution of the shareholders was passed, ratifying their acts, after five years of the commencement of the alleged violations. This order sets out a precedent which can be utilized to remedy all violations and hence, render the very basis of the regulations formulated by the Securities and Exchange Board of India nugatory. The order is also contrary to the Securities Contracts (Regulation) Act, 1956 and the Companies Act, 2013. All norms of investor protection and corporate governance have been jettisoned by the Securities Appellate Tribunal.

The author raises five questions in the context of the order and tries to answer them. One, can shareholder consent supersede Parliamentary law? Two, can regulatory checks which exist for investor protection be circumvented through a special resolution of the shareholders? Three, can non-compliance with corporate governance norms be approved through shareholder ratification at a later date? Four, is there a timeline for this approval through ratification? In the present case the ratification occurred after five years. And the fifth being what the scope of the ratification is i.e., what all acts are within the competence of the shareholders to be ratified and approved?

[*] The Author is an Assistant Professor of Law at The University of Petroleum & Energy Studies, Dehradun.

Keywords: Securities Appellate Tribunal, Terrascope Ventures, investor protection, SEBI

TABLE OF CONTENTS

I. INTRODUCTION 2
II. THE EARLY FACTS 3
III. END OF THE INVESTIGATION 7
IV. ORDER OF THE ADJUDICATION AUTHORITY 8
V. THE SECURITIES APPELLATE TRIBUNAL ORDER 11
VI. QUESTIONS THAT EMERGE 12
VII. FURTHER ANALYSIS 17
VIII. CONCLUSION 18

I. INTRODUCTION

The Securities Appellate Tribunal ("**SAT**") handed down its decision on 2nd June 2022 in three separate appeals, filed by Terrascope Ventures Limited (formerly Moryo Industries Limited), and its two directors Geeta Manoharlal Saraf and Manoharlal Saraf.[1] The tribunal absolved the company and the two directors of all regulatory violations since the acts for which they were penalized by the Adjudicating Officer ("**AO**") of Securities and Exchange Board of India's ("**SEBI**") were subsequently ratified by the shareholders. This ratification happened after 5 years, and after a probe by Securities Exchange Board of India had begun.

[1] Terrascope Ventures Limited v. Securities and Exchange Board of India, Appeal No. 116 of 2021, decided on 02-06-2022 by the Securities Appellate Tribunal (India) [hereinafter, Terrascope v. SEBI].

The SAT order goes against the corporate governance norms laid down under the Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003, the Listing Agreement with the Stock Exchange (Bombay Stock Exchange), Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009, Securities Contracts (Regulation) Act, 1956, and the Companies Act, 2013.

The matter pertains to utilization of funds raised from a preferential allotment of shares for ends other than for which shareholder consent was taken. The decision of the SAT establishes a precedent wherein all misconduct and non-compliance with regulatory framework can be post facto cleared and made legal through a special resolution of the shareholders. This opens up a line of argument for violators of SEBI regulations. These regulations exist to protect investor interest, confidence in the market and ensure proper corporate governance norms in listed entities.

The first part of the paper deals with the facts which lead to a SEBI investigation. In the second part, the orders of the Adjudicating Officer and the SAT are discussed and analysed. Finally, the author raises five questions which the SAT order does not delve into. Also, codified provisions regarding corporate governance norms which have been ignored by the SAT are highlighted.

II. THE EARLY FACTS[2]

SEBI had noticed an enormous rise in the price and the traded volumes of the shares of Moryo Industries on the Bombay Stock Exchange, during the investigation period starting from 15th January 2013

---

[2] Moryo Industries Ltd., In re (Dealing in the scrip), 2014 SCC OnLine SEBI 91 (India). The facts are primarily sourced from the order of the Whole Time Member, Mr. RK Agarwal. Reference no. - WTM/RKA/140/ISD/2014.

to 31st August 2014. The price of the scrip had gone up from Rs. 93.4 to Rs 225.

A preferential allotment of 63,50,000 shares by Moryo was made to 42 individuals on November 9th, 2012, at a price of Rs. 25 per share. On January 15, 2013, shares in Moryo were split on a 1:2 ratio. The shares held by the 42 allottees as a result of the preferential allotment and split were locked in and not transferable until November 8, 2013, in accordance with the SEBI (Issue of Capital and Disclosure Requirements Regulations), 2009.

Moryo was a consistent loss-making entity with reported losses of Rs. 91,043/-, Rs. 1,32,370/- and Rs. 1,428,739/- during the FY 2011-12, FY 2012–2013 and FY 2013–2014 respectively. The revenue of the company had grown from Rs. 1,10,00 during FY 2011–2012 to Rs. 5,34,91,444 during FY 2012–2013, on account of its share trading activities with its connected entities. The company had no business activity during the FY 2012-2013.

In spite of this poor state of affairs the company was able to raise Rs. 15,87,50,000/- by issuing 63,50,000 shares to 42 entities at Rs. 25/- per share. According to SEBI, this could not be termed as rational investment behaviour and hence, warranted an investigation.

The increase of prices and volumes of the scrip were notably high after the expiry of the lock-in period. During the investigation it was discovered that entities that were connected/related to Moryo had traded between each other to create artificial volume and price increase.

Moryo, during the inquiry had disclosed that it had invested 66% of proceeds of preferential allotment in shares of listed as well as unlisted companies and rest of the money was given as loans and advances to certain entities.

According to a copy of the special resolution passed under section 81(1A) of the Companies Act of 1956, SEBI discovered that Moryo had informed its shareholders and the general public that the funds would be raised through the aforementioned preferential allotment to meet requirements for:

a) capital expenditures, including the acquisition of a company or business.
b) financing necessary long-term working capital needs
c) Marketing
d) establishing offices overseas and
e) for further authorised corporate purposes.[3]

It is a point of special importance that Moryo had no business activity during the said period and the money so raised was not used for the purposes for which the shareholder consent was taken.

It was further disclosed by Moryo that the loans and advances made from the proceeds of the preferential allotment were without any loan agreement and on examination SEBI found that most of these companies had a common promoter.

SEBI had also received a reference from the office of the director of Income Tax (Investigation), Kolkata, regarding usage of preferential allotment route for claiming long term capital gains which was tax exempt.

Hence, according to SEBI, the modus operandi for market manipulations were as follows:[4]

i. the listed company had poor financials, no business activity and its scrip was being traded at meagre prices.

---

[3] Badri Lal Birla, In re, 2019 SCC OnLine SEBI 28, order of Whole Time Member Ananta Barua. Reference No.- WTM/AB/EFD-1/DRA-4/26/2018-19.
[4] 52 Weeks Entertainment Ltd. v. BSE Limited, 2015 SCC OnLine SAT 53 (India).

ii. the entity then raised huge sums by preferential allotment of shares which had a lock-in period.

iii. money so received was not used for the disclosed purpose.

iv. there was no significant improvement in the performance of the company, yet there was sizeable increase in the share price.

v. the share prices were manoeuvred by persons/entities connected to the company and/or to the allottees of the preference shares, and the market prices were pushed up significantly on relatively small volumes.

vi. the allottees then sold their shares after the lock-in period was over at such manoeuvred and manipulated increased prices to connected parties and made astronomical profits which were also exempt from tax as they were a part of long term capital gains.

As a result the Whole Time Member ("**WTM**") of SEBI in his ex-parte ad-interim order,[5] on 4th December 2014 had restrained, till the completion of investigation and passing of the final order, the involved persons and entities (98 in number) from either directly or indirectly buying, selling or dealing in the securities market.

Since this was an ex-parte ad interim order, the affected parties were allowed to file their objections and avail a personal hearing. Some of the parties involved, including Moryo, and its directors utilised this opportunity to file objection to get the ex-parte ad-interim order. The company and its directors were unsuccessful to establish a plausible explanation/reasoning for their acts and omissions and hence, the order dated 4th December 2014 was confirmed against the company and the directors on 22nd August 2016[6]. But the earlier directive issued against 10 of the entities was revoked. Earlier, an order dated 18th March 2016, had

---

[5] Terrascope v. SEBI, *supra* note 1.

[6] Moryo Industries Ltd., In re, 2016 SCC OnLine SEBI 327 (India).

confirmed the interim order against 20 entities as they had not replied to the interim order, neither availed the personal hearing.[7]

III. END OF THE INVESTIGATION

The interim order had led to an in-depth investigation by the SEBI against the remaining 88 entities. The scrutiny did not find any adverse finding/evidence against 85 entities in their alleged role of manipulating Moryo's stock price. The fetters placed on their dealings in the securities market were duly revoked.[8]

The remaining 3 entities -Moryo Industries Limited, and the directors Manoharlal Saraf and Geeta Manoharlal Saraf were however not absolved and the directives against them continued.[9]

The interim order had stated that there was an alleged violation by these three entities of the SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003 ("**PFUTP Regulations**"). That their acts and omissions were '*fraudulent*' as defined under Regulation 2(1)(c) and were in violation of the provisions of Regulations 3 and 4 of the PFUTP Regulations.

---

[7] Moryo industries Limited, In re, 2016 SCC OnLine SEBI 255 (India).
[8] Moryo Industries Limited, In re, 2017 SCC OnLine SEBI 202 (India) [hereinafter, Moryo Industries Limited 2017].
[9] *Id.*

IV. ORDER OF THE ADJUDICATION AUTHORITY[10]

An AO was appointed to adjudicate upon the alleged violations of the PFUTP Regulations by the Company and its two Directors. The fact which was in focus was that the company had not utilised the money raised from the preferential allotment for the disclosed purposes, and had instead diverted the money for extending loans and advances.

Under Regulation 73(1)(a) of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 ("**ICDR Regulations**") it was mandatory to disclose the objects of the preferential issue in the notice sent for shareholder approval in the general meeting. A special resolution of the shareholders in the general meeting was required to make a preferential issue in accordance with Section 81(1A) of the Companies Act, 1956, read in conjunction with Regulation 72 of the ICDR Regulations.

Hence, the disclosure as to the proposed use of funds was needed to help the shareholders make an informed decision regarding the issue of preferential shares. Their consent was taken for the use of the funds towards particular specified objectives.

The AO categorically re-iterated the foundational doctrine of corporate law that a company is a separate legal entity and it could act

---

[10] The orders of the AO against the three entities – Moryo Industries and the two directors were issued on the same day. The AO was also the same. Since the cause of action arises from the same set of facts, the orders are discussed under the same heading here.
ADJUDICATION ORDER NO. Order/PM/NK/2020-21/7579 -In respect of Mr. Manoharlal Saraf
ADJUDICATION ORDER NO. Order/PM/NK/2020-21/7582 - In respect of Mrs. Geeta Manoharlal Saraf
ADJUDICATION ORDER NO. Order/PM/NK/2020-21/7578 - In respect of M/s Moryo Industries Limited
(All passed in the matter of Investigation in the matter of Trading Activities of Certain Entities in the Scrip of Moryo Industries Limited).

only through its directors. It is expected that they act within the legal framework and exercise due diligence.

He then went on to decide the question whether the company and the directors had violated Regulations 3(a), 3(b), 3(c), 3(d), 4(1),4(2)(f), 4(2)(k) and 4(2)(r) of the PFUTP Regulations part. Whether Section 21 of the Securities Contracts (Regulation) Act, 1956 ("**SCRA**"), read in conjunction with Clause 43 of the Listing Agreement, was contravened was another separate issue.

In general, the PFUTP's Regulations 3(a), 3(b), 3(c), and 3(d) forbid manipulating stock prices and engaging in fraudulent securities transactions. Additionally, they forbid engaging in any behaviour or practice that may be seen as fraud or deception in connection with issue of securities. Manipulative, fraudulent and unfair trade practices are proscribed by Regulation 4. Regulation 4(2) describes activities which shall be in the nature of fraudulent or unfair trade practices. Activities enumerated in clauses (f), (k) and (r) are publishing or reporting information which is not true, advertising that is misleading or distorted to influence investors and planting of false news to induce sale or purchase of securities respectively.

Section 21 of the SCRA lays down the condition for listing and it is explicitly stated that the company has to comply with the listing agreement of the stock exchange (in this case the Bombay Stock Exchange). And Clause 43 of the Listing Agreement mandates that the company has to, on a quarterly basis, disclose the variations, along with an explanatory statement, between projected utilisation and actual utilisation of funds generated through preferential allotments.

The AO relied on the disclosures made by Moryo during investigation in which it had itself accepted that the preferential allotment funds raised were diverted for purchasing shares of other companies and extending loans and advances to entities.

The directors did not reply to the show cause notices and notices to avail opportunity of personal hearing which were sent to them. The AO presumed that since the notices were duly served, the allegations had been accepted.

The company did reply to the notice and their reply stated that –

i. The Memorandum of Association ("**MoA**") duly empowered the company to advance money to companies
ii. Due to the prevailing market conditions the amount raised through preferential allotment could not be utilised towards the objects of the issue. A part of the sum was only utilised for investments in shares and lending, which had since been repaid. The remaining part was utilised for working capital and investments.
iii. In 2014, the company had altered its object clause to include financial activities through a special resolution passed by the shareholders. And the money which was received back from the preferential allotment amount after investing in shares and lending activities was utilised as per the amended object clause.
iv. There was no misuse of the amount raised through preferential allotment. Hence, Clause 43 of the Listing Agreement was not applicable.
v. The company also stated that its shareholders had approved and ratified the usage of the funds so raised by passing a special resolution in an Annual General Meeting.

The AO was of the opinion that it was clearly a case where the funds had been not utilised for the purpose that they were raised. He relied on the company's disclosure to that end and the material available on record. The company had not delved into the market conditions which prevented it from utilising the funds as per the objects of the preferential issue. It had also not complied with the requirements of the Listing Agreement

under clause 43 and was in violation of the same and Section 21 of the SCRA.

He also carved out a differentiation between the objects of the preferential allotment and the objects of the company as stated in its MOA. The objects of the preferential allotment reflected the specific motive for which the funds were raised. On the other hand the MOA talks about the broad scope of functioning of the company.

While reading the MOA, the AO came to a conclusion that it did not authorise the company to give loans or advances, it only permitted the company to act as security or give guarantees.

The argument that the company had in 2014 modified its objects clause to include financing investing and share trading, also held no water, as a post facto amendment could not have remedied the earlier illegality.

In its reply Moryo had specifically stated that it had through special resolution of its shareholders been accorded their approval for any actions taken by the company in entering into and carrying out the use of the funds from the preferential issue. Hence, the argument was that a post-facto ratification was in place towards those activities which were in variance to the objects of the preferential issue.

The AO categorically and empathically stated that illegal acts and deeds of a company could not be ratified by the shareholders to make those actions legitimate post-facto.

Ultimately monetary penalties were imposed on the company as well as its two directors for violation of SEBI regulations and the SCRA.

V. THE SECURITIES APPELLATE TRIBUNAL ORDER

The SAT had clubbed the appeals of the company and its two directors and decided the case together since the facts and issues were

common in all three appeals. By this time the company has changed its name to Terrascope Ventures Ltd.

In a brief order written by the presiding officer Justice Tarun Agarwala, all the impugned orders that had been passed by the AO were quashed. The reasoning was simple. All the utilisation of proceeds which were in variance to the object of the preferential issue were ratified and approved by a majority of the shareholders through a special resolution. The shareholders had also ratified and approved for any actions taken by the company in entering into and carrying out the use of the funds pursuant to the preferential issue.

According to the presiding officer once this special resolution dated 29 September 2017 was passed, the application of the raised funds towards the purchase of shares and giving loans and advances became the objects of utilisation of the company.

VI. QUESTIONS THAT EMERGE

The SAT order raises a few questions which need to be dwelled upon –

i. Can shareholder consent supersede Parliamentary law?
ii. Can regulatory checks which exist for investor protection be circumvented through a special resolution of the shareholders?
iii. Can non-compliance with corporate governance norms be approved through shareholder ratification at a later date?
iv. Is there a timeline for this approval through ratification? In the present case the ratification occurred after five years, and
v. What is the scope of the ratification i.e. what all acts are within the competence of the shareholders to be ratified and approved?

Accordingly, the author will analyse each of these issues individually.

A. CAN SHAREHOLDER CONSENT SUPERSEDE PARLIAMENTARY LAW?

Section 21 of the SCRA is a mandatory provision. It clearly states that the compliance with the listing agreement is compulsory. There exists no provision within the SCRA for approval and ratification of the acts and dealings which are in contravention of Section 21. In fact, under Section 23(2), the penalty prescribed for contravention of Section 21 is "*imprisonment for a term which may extend to ten years or with fine, which may extend to twenty-five crore rupees, or with both"*. The Companies Act (both 1956 and 2013) also does not contain any provision which enables shareholders to approve and ratify acts for which imprisonment and high monetary penalties are prescribed.

In Ashbury Railway Carriage and Iron Co. Ltd. v. Riche[11], the shareholders had attempted to ratify the acts of the Directors which were beyond the objects as defined in the MOA. The House of Lords had in their decision emphatically stated that the shareholders could not have ratified an act beyond the objects. The exact words being – "*The shareholders would thereby, by unanimous consent, have been attempting to do the very thing which, by the Act of Parliament, they were prohibited from doing*." The same logic can be extended to the present question.

The very intent of Clause 43 of the Listing Agreement can be gathered from the language used. The shareholders need to be informed on a quarterly basis regarding the usage of the funds raised. It is a check on the company that the funds are being utilised for the purpose they were raised for. This provision is aimed at holding those in charge of affairs accountable for the proper usage of the funds raised from investors. Hence, what is aimed is corporate governance through a system of proper disclosures from the company's end. And in case of non-compliance, one

[11] Ashbury Railway Carriage and Iron Company v. Riche [L.R.] 7 H.L. 653.

can be held accountable through Section 21 of the SCRA. Also, it enables investors/shareholders to take legal recourse against the company, when so informed through the disclosures.

B. CAN REGULATORY CHECKS WHICH EXIST FOR INVESTOR PROTECTION BE CIRCUMVENTED THROUGH A SPECIAL RESOLUTION OF THE SHAREHOLDERS?

The mandate of SEBI can be understood from the long title of the SEBI Act, 1992. It has broadly a threefold mandate:

i. establishment of a Board to protect the interests of investors in securities
ii. to promote the development of the securities market and,
iii. to regulate the securities market.

The same is also reiterated under Section 11 of the Act. To achieve these objectives, the Board is empowered to make regulations under Section 30 of the Act. These regulations are to be placed before the Parliament as prescribed under Section 31 of the Act.

Thus, all SEBI regulations which exist for investor protection carry the stamp of approval from the Parliament. Regulatory checks exist for the market at large and regulation of the securities market can only occur if all entities engaged in them comply with these in good faith. If one entity, to gain an advantage, could get ratification from its shareholders for non-compliance with the regulations, so could others, and this would render all regulations made by SEBI nugatory. Hence, one company's shareholders cannot ratify actions which have impacted the entire securities market. The market as a whole is affected through non-compliance and not just the shareholders of the company in violation.

If a situation is allowed wherein non-compliance with investor protection regulations can be okayed by shareholders (which the SAT

order does), then the shareholder approval can become a route to exploit investors. Money can be raised from them for a specific purpose and then shareholders can alter the usage by passing a special resolution. If the majority has a substantial voting rights percentage, passing a special resolution might also not be a hindrance.

C. CAN NON-COMPLIANCE WITH CORPORATE GOVERNANCE NORMS BE APPROVED THROUGH SHAREHOLDER RATIFICATION AT A LATER DATE?

The listing agreement and the ICDR regulations prescribe for proper notices, disclosures and regular reports from a company so as to ensure transparency in the securities market. This ensures accountability of the people in charge (i.e. Directors in this case).

There is a mandatory provision for disclosing to the shareholders the objects for which the money is to be raised in a preferential allotment so that a considered decision can be taken by them to approve or not to approve the same. Then, quarterly reports are mandatory to determine whether there has been any variance in the usage. If shareholders can ratify the failure to observe these norms then SEBI would become toothless, and all corporate governance norms can be circumvented through this route. Especially in scenarios where those in charge of the company's affairs still hold a seventy five percent stake, as the minimum public shareholding requirement is of twenty five percent as per the SCRA[12].

Investors who take calls based on analysing disclosures by the company and their own research, can be easily exploited by unprincipled corporate actors. There will simply be no check on the majority if

[12] Securities Contracts (Regulation) Rules, 1957 (India), Rule 19 A.

corporate governance norms can be jettisoned by a special majority. This will also impact and shake investor confidence.

SAT chooses to disregard the fact that Terrascope had neglected to divulge the mis-utilisation/difference in fund use for almost five years (four quarters per year) and in its obligatory disclosure reports for the time. How can these be excused by a later ratification?

D. IS THERE A TIMELINE FOR THIS APPROVAL THROUGH RATIFICATION? IN THE PRESENT CASE THE RATIFICATION OCCURRED AFTER FIVE YEARS.

In the case of to Terrascope Ventures Ltd., the issue of the preference shares occurred in 2102, whereas the special resolution which forms the basis for the SAT order was passed in 2017. This is a gap of five years. The investigation of SEBI in the matter was drawing to a close at this time. The company had also passed a special resolution to alter its object clause in 2014 to seek legitimacy for the funds raised through the preferential allotment. It can be clearly inferred that the company was trying all tricks in the book to get off the hook for regulatory violations. The SAT order does not discuss what the acceptable timeline for ratification is. It does not list down any outer limit for the same. The SAT order could be easily construed to mean that approval through ratification can be sourced at any point of time. It could also mean that any application for oppression and mismanagement by the minority shareholders alleging mismanagement of raised funds could be dismissed based on a ratification because there might be no offence made out by SEBI.

E. WHAT IS THE SCOPE OF THE RATIFICATION I.E. WHAT ALL ACTS ARE WITHIN THE COMPETENCE OF THE SHAREHOLDERS TO BE RATIFIED AND APPROVED?

The SAT order does not mention the scope of the ratification power of the shareholders. Is it a blanket approval and ratification power? Is it qualified? What are the regulatory violations for which this power can be used? Can it also be used to remedy statutory violations? These are the questions left unanswered by the SAT order.

VII. FURTHER ANALYSIS

The case highlights the enduring nature of SEBI investigations. What began in 2012 is still in courts in 2022. The SEBI has challenged the SAT order in the Supreme Court[13]. It is hoped that the Supreme Court answers the questions raised in this article. An alternative would be to simply affirm the succinct and reasoned order of the AO. The SAT order strikes at the core of the SEBI regulatory architecture and its goals.

Further, according to Section 27 of the Companies Act, 2013 which became effective from 1st April 2014, a company can vary the objects of its preferential issue if it is able to secure such authority through a special resolution in a general meeting. However, the second proviso to Section 27(1), clearly states that "*such company shall not use any amount raised by it through prospectus for buying, trading or otherwise dealing in equity shares of any other listed company*". In its own disclosures made,[14] the company had bought shares of Geojit BNP Paribas Financial Services Limited which is a listed entity. Hence, in spite of the special resolution passed, the Company and its directors are in violation of statutory provisions.

---

[13] Securities And Exchange Board Of India v. Terrascope Ventures Limited (C.A. No. 005209 - 005211 / 2022) (Registered on 08-08-2022) Diary No.- 23328 – 2022.
[14] Moryo Industries Limited 2017, *supra* note 8.

Under Section 27(2) of the Companies Act, the dissenting shareholders need to be given an exit offer as per the rules framed by SEBI. There is no discussion on this in any of the orders passed.

Rule 7 of Companies (Prospectus and Allotment of Securities) Rules, 2014 further states that for a special resolution to be passed to vary the objects, a notice detailing the following needs to be sent to the shareholders - the original purpose or object of the issue, the total money raised, the money utilised for the objects of the company stated in the prospectus, the extent of achievement of proposed objects (that is fifty percent, sixty percent, etc.), the unutilised amount out of the money so raised through prospectus, the particulars of the proposed variation in the terms of contracts referred to in the prospectus or objects for which prospectus was issued, the reason and justification for seeking variation, the proposed time limit within which the proposed varied objects would be achieved, etc.[15]

Moryo (Terracope) was fined Rs. 5 lakh by SEBI for manipulating the share price of Tilak Ventures Limited.[16] This knowledge alone should have made SAT reconsider before endorsing the behaviour of this entity.

VIII. CONCLUSION

The operative and reasoned portion of the SAT order is barely four pages and focuses just on the definition and the meaning of the word 'ratification' without delving into the legality and the consequences of the same. It highlights the incompetence of the SAT members in matters related to corporate laws and securities markets.

This decision has an impact on the core foundations of India's disclosure-based regulatory framework. The appellate body does not have the authority to make a ruling/inference that would have such significant

---

15 Companies (Prospectus and Allotment of Securities) Rules, 2014 (India), Rule 7(1).
16 Tilak Finance Ltd., In re, 2021 SCC OnLine SEBI 1103 (India).

effects on the investors, corporate governance norms and the capital markets.

As a final parting thought, the author is also of the opinion that such poorly reasoned decisions lead to constant appellate litigation already adding to the burgeoning court dockets.

THE GREAT INDIAN IPO RUSH: CHANGES IN LOCK-IN-PERIODS AND ITS EFFECT ON RETAIL INDIVIDUAL INVESTORS

Priya Kataria & Anubhav Jaiswal[*]

ABSTRACT

*Equity markets in 2021 saw exponential growth on all fronts, whether in terms of returns to its investors, indices trading at their lifetime high, or a boom in the primary markets due to record-breaking inductions of the Initial Public Offering **("I.P.O.").** Experiencing and witnessing this exponential growth, primarily via the I.P.O. route wherein the investors made huge listing gains, the financial market regulator, Securities and Exchange Board of India **("SEBI")** promulgated regulatory norms to meet the demands of the robust market, and at the same time, promote the culture of I.P.O. Amendments were made to various regulations specifying norms that a listed company and all categories of its investors have to abide by. Amongst various amendments made to these fiscal regulations, one of the most discussed and debated was with regards to a change in the lock-in-period for the promoters and the anchor investors to achieve the dual objective, i.e., to provide confidence to the investors who are subscribing to the I.P.O. of the company and reducing the trading volatility that the share prices undergo after the lock-in-period ceases to exists. This decision of SEBI will be critically analyzed, and the effect of these amendments on Retail Individual Investors ("**R.I.I.**") will be discussed in this paper. The concluding remarks of this research paper will analyze these steps of SEBI, the impact caused on R.I.Is, promoters, and anchor investors, and the trading volatility that the listed entity's shares undergo after the lock-in period ends.*

Keywords – Anchor Investors, I.P.O., Promoters, Retail Individual Investors, SEBI.

---

[*] The authors are Associate at SitusAMC, New Delhi and Student at Christ (Deemed to be University), Bangalore respectively.

TABLE OF CONTENTS

I. INTRODUCTION 21
II. LOCK-IN PERIOD FOR PROMOTERS AND THE REGULATION GOVERNING THIS PERIOD 23
III. LOCK-IN PERIOD FOR ANCHOR INVESTORS AND THE REGULATION GOVERNING THIS PERIOD 26
IV. EFFECT OF END OF LOCK-IN PERIOD AND HOW IS RII WEALTH IMPACTED 28
V. ANALYSIS AND SUGGESTIONS 30
VI. CONCLUSION 35

I. INTRODUCTION

Capital markets in India are a culmination of Primary and Secondary markets. When equity, securities and debt securities are issued for the first time by corporates and governments, they are issued in the primary markets. Financial instruments are born and created in the primary market, which includes public offerings and is generally dynamic and evolving. Therefore, to keep up with the dynamics of the market, there have been various changes in laws through the introduction of new regulations and amendments to the existing ones.

SEBI, in its endeavour to achieve its objective of protecting investors and ensuring a free and fair market where there is an efficient mechanism for the issuers to raise money and for the investors to invest money, has created an adequate mechanism for Public Issue, which undergoes amendments to meet the requirements of this robust regime. One of the recent amendments made by SEBI in its primary regulation, i.e., Securities and Exchange Board of India (Issue of Capital and Disclosure

Requirements) Regulations, 2018 ("**ICDR Regulations**")[1] was the change in the lock-in period.

SEBI introduced ICDR Regulations to streamline the process of I.P.O. These regulations govern the pre- and post-issue activities of the listed entity. ICDR Regulations set out the norms a listed entity must adhere to before issuing securities to the public. Additionally, they lay down norms for promoters, selling shareholders, and anchor investors of the issuing company. Amongst the other requirements, ICDR Regulations specify the lock-in period for the promoters and anchor investors. The lock-in period is the duration for which the anchor investors cannot sell their allotted securities.

Therefore, this article will provide readers with an in-depth understanding of what a lock-in period for anchor investors/promoters signifies and the legislative intent behind the lock-in period. The authors will also critically analyze the impact and the reasons behind the amendment and the recent trends of the I.P.O. markets. The authors have provided a brief reason for this amendment by analyzing one of the trends in the introduction, i.e., the boom in the I.P.O. market, to give readers clarity about the trends in the I.P.O. market and the legislative intent behind these amendments in brief.

In 2021 there was a record-breaking listing wherein a total of sixty-three companies collectively raised Rs. 1.2 lakh crore through an Initial Public Offering.[2] The investors were able to lap in various I.P.O.s. The investors faced the problem that many listings, such as Nykaa, Zomato, and Paytm were trading way below their issue price, which had caused

---

[1] Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018 Gazette of India, pt. III sec. 4, (Sept. 11, 2018) [hereinafter, ICDR Regulations].

[2] Sanam Mirchandani, *A Blockbuster Year for public offers despite Hiccups*, ECON. TIMES, (Jan. 1, 2022) https://economictimes.indiatimes.com/markets/ipos/fpos/2021-a-blockbuster-year-for-public-offers-despite-hiccups/articleshow/88627581.cms.

considerable losses to the anchor investors and the retail investor. As per a report, Paytm investors have lost around seventy-two percent of their investment[3]. Not only this, the biggest issue in the history of primary markets, i.e., the issue of Life Insurance Corporation of India (L.I.C), saw its listing way below the issue price. As of now, the investors in L.I.C have nearly lost more than Rs. 1.08 lakh crore since its listing, which has increased even more after a considerable correction was witnessed in the Nifty 50 and Sensex.

Therefore, amidst such volatility and turmoil in the primary market, the regulators had to ensure that the investors' money was protected and the regulation was up to the mark to ensure that there was no exploitation and wrongdoing on the Issuer's part. Therefore, SEBI brought various amendments to its regulations. Now, let us understand what exactly lock-in period refers to.

II. LOCK-IN PERIOD FOR PROMOTERS AND THE REGULATION GOVERNING THIS PERIOD

The time duration for which the investors cannot sell their investment or cannot retrieve their invested amount that duration is known as the lock-in period.[4] The legislative intent behind the lock-in provision is to ensure commitment of the promoters, the anchor investors, or those who have received the preferential allotment of securities towards the listed company. These provisions prevent offloading or dumping of securities as and when the investors receive their allotment and prevent them from taking benefits of the price arbitrage.

---

[3] Kundan Kishore, *Paytm investors lose 72% since listing: What should existing investors do?*, OUTLOOK INDIA, (Mar. 15, 2022) https://www.outlookindia.com/business/paytm-investors-lose-72-since-listing-what-should-existing-investors-do--news-186975.

[4] *IPOs: SEBI extends lock-in period for anchor investors to 90 days,* LIVEMINT, (Dec. 28, 2021) https://www.livemint.com/market/stock-market-news/ipos-sebi-extends-lock-in-period-for-anchor-investors-to-90-days-11640697370859.html.

The regulations provide lock-in periods for the promoters of the company, the anchor investors, and those investors who have received the preferential allotment of securities. This section will analyze and provide the readers with an understanding of the regulations that deal with the lock-in period.

The regulation that governs the lock-in-period is the ICDR Regulations 2018, and as per Regulation 16 of the ICDR Regulations (before the amendment), the Minimum Promoter's Contributions ("**MPC**") of 20% are locked in for a period of three years from the commencement of commercial production or the date of allotment in the I.P.O. whichever of the two is later. Further, provided that any promoter who holds more than the MPC has an additional lock-in period of one year from the date of allotment in the I.P.O. The objective of this lock-in period was to ensure "skin in the game" for the issuer company, which is trying to raise capital through the I.P.O.

However, the Primary Market Advisory Committee ("**PMAC**") had other recommendations that were put forth before the regulators i.e., if an issuer company is coming up with an issue whose object involves an Offer for Sale ("**OFS**") or financing other than for capital expenditure of a project, the MPC of 20% should be locked-in period for a period of one year.[5] The objective behind this recommendation was that firstly, i.e., since India is witnessing a plethora of I.P.O.s being introduced, there must be investments that are being made in these I.P.O.s, and if the promoters feel that their money will be blocked for the next three years with the company and they will not be able to sell their investments; there is a possibility that they may be hesitant to invest. Therefore, a reduction

[5] Consultation Paper on Review of certain aspects of public issue framework under SEBI (Issue of Capital and Disclosure Requirements) Regulations (Sec. and Exch. Bd. of India, 2018), 2021, https://www.sebi.gov.in/reports-and-statistics/reports/nov-2021/consultation-paper-on-review-of-certain-aspects-of-public-issue-framework-under-sebi-issue-of-capital-and-disclosure-requirements-regulations-2018_53983.html [hereinafter, Securities and Exchange Board of India].

in the lock-in period will enable them with an option to sell their investments after a period of one year, and they can book profits after one year. Secondly, the objective behind the lock-in period is to ensure the retail investors have faith in the functioning and financial stability of the company during the I.P.O. since they do not have the kind of information or knowledge about the company that a promoter may have. However, once a company is listed, it has to make disclosures as per the ICDR Regulations and, Listing Obligation and Disclosure Requirement ("**LODR Regulations**") about its financial results, block deals, mergers, and acquisitions, etc., enabling the retail investors to research and make a decision thus, obviating the there is no need for a lock-in period of three years. Therefore, understanding the need of the hour, the regulators accepted these recommendations, which were made and stated that –

1. There is a need to change the lock-in period for the twenty percent of MPC from three years to one year from the date of allotment, and shareholding over the MPC may be locked in a period of six months rather than one year. With the exception that the lock-in period of three years of MPC may continue in the majority of an issue where there is no OFS portion utilized towards capital expenditure.

2. The same kind of lock-in shares would apply to further public offerings (FPO).

Thus, when SEBI accepted these recommendations, the SEBI ICDR Regulations, 2018 were amended by way of SEBI ICDR (Third Amendment) Regulations, 2021 ("**ICDR Amendment 2021/the Amendment**") in August 2021.

The authors find this amendment progressive because the three-year lock-in period is relatively restrictive from the promoters' point of view. It must be understood that the regulators designed and introduced the lock-in period to prevent offloading and dumping of shares so that there is not

a drastic fall in the share price of the Issuer company. However, a term of one year is sufficient for the company's share price to settle and showcase its financial performance in the market to gain public trust. Even if the promoters offload their securities after one year, the company's shareholders will not be worried by the minor fluctuation in the price of the shares. The financial performance over the past four quarters and the vision/aim of the company are well-known to its investors. Thus, it gives them confidence in the company with strong financial performance.

On the contrary, if the company's financial performance is not up to the mark, the investors have a period of one year to exit and sell their position in the market. Therefore, justifying the amendment, i.e., reduction of the lock-in period. However, the same may not be applicable for anchor investors as 90 days is not sufficient for the investors to judge the financial performance because the company may not be obligated under the LODR Regulations to report its finances during that course and also for the share price to settle. Their selling leads to a drastic change in the share prices, for which the authors have provided various examples in the succeeding sections.

III. LOCK-IN PERIOD FOR ANCHOR INVESTORS AND THE REGULATION GOVERNING THIS PERIOD

Anchor Investors is a fairly new concept that the SEBI introduced in the year 2009. Anchor investors "mean a qualified institutional buyer who makes an application for a value of at least ten crore rupees in a public issue on the main board made through the book building process by these regulations or makes an application for a value of at least two crore rupees for an issue made following Chapter XI of these regulations."[6]

[6] ICDR Regulations, *supra* note 1, Reg. 2(1)(c).

These anchor investors are also known as the "cornerstone investors" because they are allotted shares one day before the IPO is made public for the investors to subscribe. These are institutional investors whom the companies invite before the IPO to subscribe to the issue to increase its popularity and earn the trust of the retail investors.

The portion reserved for the anchor investors depends upon the profitability track record of the company. Companies that show profits on their balance sheet for the previous three years when filing an IPO have to reserve fifty percent for the Qualified Institutional Buyers ("**QIBs**"), and a company with no profitability record has to reserve around seventy-five percent of their Issue for QIBs.[7] The ICDR Regulations provisions clearly state that the issuer company can allocate sixty percent of the QIB portion to the anchor investors on a discretionary basis, out of which one-third is reserved for mutual funds.[8]

In, a consultation paper[9] SEBI stated that the concept of anchor investors was brought into the market because they provide an indication of pricing and help with price discovery during the IPO by instilling trust in the issue, especially when they deposit money upfront. Other investors can follow the lead of the anchor investors. Therefore, looking at the objective as to why these anchor investors' concept was introduced, SEBI felt that there was a need to have a lock-in period for a longer time frame.

On this, the PMAC commented that instead of increasing the lock-in period for the anchor investors, not more than fifty percent of the anchor book should not be given to those anchor investors who do not agree to a lock-in period of ninety days or more.[10] SEBI, in a press release,

---

[7] *Id.*, Chapter-II, Pt. 1, Reg 6(2).
[8] General Information Document for Investing in Public Offers (Sec. and Exch. Bd. of India2020),
https://www.sebi.gov.in/sebi_data/commondocs/mar2020/Annexure%20PO_p.pdf.
[9] Securities and Exchange Board of India, *supra* note 5.
[10] *Id.*

announced that the current lock-in period of thirty days shall continue for fifty percent of the portion which has been allocated to the anchor investors and for the remaining portion, a ninety-day lock-in period should be observed for all issues from 1st April 2022.[11]

The basic objective of increasing this lock-in period, was to bring in discipline and ensure that anchor investors are anchored; and do not behave as momentum investors because they have a preferential kind of allotment before the IPO, and the retail investors look at these anchor investors and invest their moneys. When the lock-in period ends, there is a sudden breakdown in stocks which will be analyzed in the next section but ensuring that fifty percent of anchor investors stay for ninety days is a good and progressive move by the regulators. One more reason that this move can be considered a good move is that there will be selling on the part of the anchor investors in two batches, i.e., fifty percent in 30 days and the rest fifty percent after 90 days which will prevent offloading or dumping of shares at a particular time altogether which was done prior to the amendment.

To ensure less volatility in the market, these rules are pretty much the need of the hour. The next section of this paper will discuss the effect of the end of the Lock-in period and demonstrate why these changes were required.

IV. EFFECT OF END OF LOCK-IN PERIOD AND HOW IS RII WEALTH IMPACTED

The expiration of lock-in periods can either be a tense experience or a buying opportunity for investors. The share prices of tech start-ups like Zomato, Nykaa, and Paytm have resulted in massive wealth destruction for investors. The companies mentioned above, which had a combined

---

[11] Press Release, Securities and Exchange Board of India, SEBI Board Meeting PR No. 38/2021, (Dec 28, 2021), https://www.sebi.gov.in/media/press-releases/dec-2021/sebi-board-meeting_55018.html.

market value of Rs 3.58 lakh crore on Day 1 of their listings, have eroded Rs 1.30 lakh crore[12] in investor wealth so far. This drew the attention of the SEBI, as most of these new-age tech IPOs were oversubscribed. However, the excessively high valuations were unjustifiable, and investors began to regret their decisions after betting on new-age technology companies **("NATC").** In a discussion paper, SEBI proposed that an extended lock-in period be implemented to protect the interests of other investors.[13]

PMAC suggested that at least 50% of the anchor book have a 90-day lock-in. A 30-day lock-in period allows anchor investors to sell their holdings after 30 days, resulting in significant fluctuations in the stock price.[14] According to experts, this has a significant negative impact on the interests of smaller retail investors.[15] For example, shares of Zomato, SBI Card, Nykaa, and Paytm fell drastically after the mandatory lock-in period for anchor investors had expired.[16] Despite the bull run, these IPOs have failed at bourses not because of market-related factors but because of the anchor's intent when backing up an IPO. Many a time it has been observed that the selling pressure on the day of the exit, there is a sudden price drop, and the whole market goes for the toss near the end of the 30-day lock-in period which presents a new opportunity for investors, who missed out on buying shares during an IPO or any drop in the share price before the lockup period expires to buy the share at a lower price. The concept of retail investor trust can also be understood by comparing

---

12 Amit Mudgill, *Investors' losses in Paytm, Nykaa, PB, and Zomato mount to Rs 1.3 Lakh crore since Day 1*, ECON. TIMES, (Feb. 18, 2022) https://economictimes.indiatimes.com/markets/stocks/news/investor-losses-in-paytm-nykaa-pb-zomato-mount-to-rs-1-3l-cr-since-day-1/articleshow/89636423.cms [hereinafter, Amit Mudgill, ECON. TIMES].

13 Securities and Exchange Board of India, *supra* note 5.

14 *Id.*

15 Amit Mudgill, ECON. TIMES, *supra* note 12 at 6.

16 Ashish Rukhaiyar, *Zomato shares touch new lows as lock-in period ends,* BUS. TODAY, (June 25, 2022) https://www.businesstoday.in/markets/company-stock/story/zomato-shares-touch-new-low-as-lock-in-period-ends-342568-2022-07-25.

anchor-backed and non-anchor-backed IPOs, explaining why the anchors that backed the IPO gave RII confidence. However, after coming across IPOs which wiped off investors' money though they were backed by Anchor Investors, the confidence of retail investors in an IPO which is backed by anchor investors is reducing. The Anchor investors' mindset should not be restricted only to listing gains but also to long-term gains in a company. SEBI's new norms for increasing the lock-in period would result in more discipline and stability in share prices even though a lock-in period of 30 days protected investors' interest from sudden fluctuations post-listing. However, the fluctuations still occurred at the end of the lock-in period of 30 days which hurt smaller retail investors, as seen in Paytm, Zomato, and Nykaa's IPOs. This may also imply that Anchor Investors must now consider the medium to long-term view of the company, which would restore RIIs' confidence or at least provide them with an assurance that Anchor investors are backing the company for a more extended period, solidifying their belief that the respective company had good fundamentals among other factors, for the investments.

There is no conclusive answer to how the end of a lock-in period will affect RII's wealth. Each company is unique, as are its stocks; some companies' stock prices rise while others fall. However, one of the main effects of the end Lock in period is that the short-term volatility increases.

V. ANALYSIS AND SUGGESTIONS

SEBI has tried its best to regulate the lock-in period in such a manner to ensure that retail investors are not affected by the big sharks of the market. The ownership structure of companies has changed a lot as several new-age tech companies are non-owned family businesses and thus, do not have an identifiable promoter group. Additionally, ownership and controlling rights do not vest with them entirely. Therefore, the PMAC while revisiting the concept of the promoter, made changes in the lock-in period and decreased the lock-in period for the promoters. This is a progressive step as per the authors due to its retrospectivity it applies to

the companies listed in the past eighteen months- as it will prevent high volatility and excess liquidity in the markets. Therefore, it will ensure that the invested money of the promoters is not held back for three years, and no liquidity crunch may hold them back from investing in new-age companies due to these stringent rules. The Indian economy has both cylinders, i.e., a consumer and a producer, especially after the government introduced the concept of "Make in India" as a policy. Therefore, India needs capital expenditure for different sectors of the economy to grow, and the reduction in the lock-in period will enable the promoters to invest in Indian Companies as they will not be facing any liquidity crunch. The companies will be benefited from these norms as promoters will be willing to invest in the initial stages of their business. With good governance, the company may produce sound financial results and a sound balance sheet, giving its investors the returns, they expected while investing and increasing the confidence of the new investors in new tech and new generation companies.

The progressiveness of the move of SEBI of bringing the changes to the current lock-in period can be checked through a comparative analysis. The authors will compare the lock-in provisions for the jurisdiction of the United States of America (U.S.) and the United Kingdom (U.K.) to provide the readers with an in-depth analysis as to what can be the plausible solutions that the regulators may adopt in order to strengthen the norms or whether the amendments are plausible enough, if yes what can be there impacts.

The U.S., in its statutory norms, does not lay down any particular lock-in period; instead, there are "lockup agreements." Lockup agreements prohibit company insiders—including employees, their friends and family, and large shareholders—from selling their shares for a set period after an IPO. In other words, the shares are "locked up." Before a company goes public, the company insiders and its underwriter typically

enter into a lockup agreement to ensure that shares owned by these insiders do not enter the public market too soon after the offering.[17]

Generally, the locked-up agreements are for a period of 180 days, and the U.S securities law also lays down guidelines to disclose these terms and conditions for lockup in their registration document.[18] This is the general practice that is followed in the U.S.

Whereas in the U.K., though, we have lock-in agreements generally, these agreements are not for a specific duration. The validity and the expiry of these agreements depend upon events in companies' calendars, such as the announcements of financial results, the publication date for an annual report, etc.[19] This gives companies discretion over the time duration of the lock-in agreements. The terms of the lock-in agreements are disclosed in the company's prospectus, which it issues to the public at large.

Therefore, in these jurisdictions, the companies generally have control over the agreements, and no specified statutory guideline governs the framework of these agreements in the U.S. and the U.K. The only statutory requirement under the securities laws of both countries is that the company mention the terms and conditions of the agreements in the prospectus. The points that are noteworthy for comparison are that in the U.S., the standard practice is that the lock-in agreement is for 180 days though it varies, and for the U.K., it is specified as per the company's calendar.

So, in India, SEBI has a statutory requirement, and it is compulsory to have a lock-in period for a certain number of days for the promoter's

---

[17] U.S Sec. and Exch. COMM'N, INITIAL PUBLIC OFFERING, LOCK-UP AGREEMENTS, https://www.investor.gov/introduction-investing/investing-basics/glossary/initial-public-offerings-lockup-agreements.
[18] *Id* at 9.
[19] Susanne Espenlaub et al., *IPO lock-in agreements in UK*, 28 J. OF BUS., FIN. AND ACCT., 1235 (2001).

anchor investors, unlike other jurisdictions where the company itself has to enter into a lock-in agreement with the insiders and decide the period of lock-in. Therefore, the authors believe that placing a lock-in period in the ICDR Regulations and amending it per the dynamic market situation is more beneficial than allowing it at the company's discretion because the company may misuse these powers to their benefit and misguide the investors.

The amendments made by SEBI for increasing the lock-in period to 90 days for anchor investors have room for improvement. The regulators can take a clue from the other jurisdiction and make the lock-in period 180 days, i.e., six months, and this is because, as per the LODR Regulations,[20] the companies are obligated to report their financial results quarterly, which may give investors an idea of how the company is performing and their financial stability. Thus, providing the investors with an exit opportunity with the anchor investors.

The authors also propose a solution by evaluating the other jurisdiction that the lock-in period should end one day after the company has announced its financial results for the very first time after being listed on the stock exchange. This may allow the investors to exit when the results are announced if the results do not depict financial stability and growth. This will also prevent their capital loss as the anchor investors would not offload all their shares before the results are declared, and this practice is generally prevalent in the U.K.

Anchor investors may have a variety of reasons to exit, including a lack of long-term interest in the stock and a desire to exit as soon as the lock-in period expires, but it was affecting these small and gullible investors who only put the money in the stock market because of these marquee investors. Hence, it was the need of the hour that the Capital

---

[20] Securities and Exchange Board of India (Listing Obligation and Disclosure Requirements) Regulations, 2015, Gazette of India, pt III sec.4, Reg 70(2), Schedule IV (Sep 2, 2015).

markets regulator brought a little discipline. It will be interesting to see how these amendments are being implemented. It will also give investors a fair idea about the company's future growth and plans, and finally, NATC which have business models of an innovative nature and are a part of the sector known as knowledge-based technology differ significantly from those of many other companies listed in India. Their priority is expansion rather than improving their financial results which not only affects the stock price negatively but after a time span even the anchor investors lose faith seeing the financial performances. But after this amendment the Anchor investors won't dump their shares all at once, there will be partial dumping which may help the RII's to decide whether they want to be invested in this stock seeing the financials and the behaviour of the Anchor investor after the initial lock-in period.

Some day traders see this as an opportunity to sell these stocks with an appropriate stop loss. They sell/short each stock released from lock-in and make decent money by taking such trades. However, day trading is highly risky and requires careful monitoring of positions, which many individual investors may be unable to do.

Long-term investors who missed out on an opportunity at the time of the opening of the Issue can invest in the stocks of the Issuer's company after analyzing the market and the moves of the anchor investors after the 30 days of the lock-in period. In both cases, investors must exercise caution.

Whereas on the other hand, the amendment may also lead to negative impacts. Anchor investors should inspire confidence in the issuer, as well as in the public at large and not act like momentum investors. It is pertinent to note that it is because of these anchor investors that the retail investors invest in new-age companies and start-ups like Zomato or Paytm, but when these anchor investors exit within the first thirty days after the Issue, it impacts the price of the shares drastically, and the retail investors are the ones who are the one's losing all the money.

Even the amendments that the regulators have made are pretty far-fetched because even if fifty percent of the anchor investors exit after thirty days, it will lead to the massive dumping of shares in the secondary market, and the retail investors will be at risk.

Therefore, the authors are of the view that the lock-in period for the anchor investors should be ninety days. They should not be allowed to exit even fifty percent after thirty days. These are investors who should not be seen as momentum investors or swing traders because the amount of money they invest is huge, and they are the "anchors" of an IPO. If they have a short-term investment plan just to grab the listing gains, how can retail investors trust them? Therefore, SEBI should come up with a new guideline for the lock-in period for the Anchor investors.

VI. CONCLUSION

Over time, the Indian capital markets have come to incorporate a robust disclosure system designed to give investors better information for making decisions while balancing the simplicity of doing business for issuers. The changes made by SEBI were the need of the hour, and the changes in the lock-in period for the promoters were progressive, but the changes which were made for the anchor investors were able to meet the objective, which was to secure the RII from incurring losses because these anchor investors exit with thirty days after the company is being listed. Authors are of the view, that the provision for allowing fifty percent of the portion which has been allocated to the anchor investor to be sold in the first thirty days, needs to be amended as it provides a way for short-term mutual funds to exit on the thirty days which affects the price of the share negatively since one-third of the portion has been reserved for mutual funds.

These investors should not invest in these IPOs to make listing gains; for them, it is pertinent that they research a company coming up for the IPO because they have the resources as well as the capacity to do so. If

they find that the company has good fundamentals, which include a strong balance sheet, financials, and a good Capex plan, so that it may provide good competition to its peers; these anchor investors, including the mutual funds, should participate in the IPO to get long-term gains. One of the other alarming aspects of this amendment is that as and when the anchor investors exit, it not only affects the price of the shares but also shakes the confidence of the RII because the participation of these anchor investors influenced their decision to invest in this. Now, if the anchor investors exit by selling off their positions, RIIs will also exit at a loss which further leads to a decline in share prices.

Though this approach taken by SEBI, may bring a lot of sanity to the markets and solve the issues of price fluctuations and increasing volatility for a short period, it is not sustainable. Therefore, further amendments are required to be made to the norms laid down for the lock-in period for anchor investors to protect the interest of the RII and the company.

NEED FOR CONVERGENCE IN STRUCTURAL ORGANIZATIONS OF BOARDS IN PUBLIC COMPANIES IN INDIA

Ashwin Bala Someshwerar[1]

ABSTRACT

The structural organization of boards in Indian companies is significant in pursuing corporate governance goals. Boards are the brains behind the successful functioning of the company. Yet, the issue of structural organization has not grabbed enough attention in academia. There are popularly two types of board structure – one-tier and two-tier. In the two two-tier structure, there is a supervisory board in addition to the management board. In this context, it is relevant to study the type of structure followed in India since it cannot be said in a single breath that it follows a strictly one-tier structure. There are overlapping functions among board members and managerial persons, which escape attention even in cases of corporate governance failures, nonetheless that being the root cause of the problems.

In this background, this paper seeks to study the nature, philosophy and pros and cons of the two types of board structure to carefully identify the critical issues to ignite an academic discussion on this topic. Also, an attempt would be made to suggest possible changes that could be made in the existing board structure by a convergence of the two types

Keywords: Board structure, supervisory board, management board, governance, and convergence.

TABLE OF CONTENTS

I. BOARD STRUCTURE IN THE INDIAN CONTEXT……………………………………………………..38

[1] The Author is an LLM student at Tamil Nadu National Law University.

II. SEGREGATION OF SUPERVISORY AND MANAGERIAL FUNCTIONS IN ONE-TIER BOARD 46
III. BOD AND CORPORATE GOVERNANCE FAILURES 47
IV. TWO TIER BOARD STRUCTURE IN GERMANY.....48
V. HARMONIZING THE PROS AND CONS OF THE BOARD STRUCTURES 50
VI. TWO-TIER BOARD AND INDIAN SCENARIO.........51
VII. TAILORING TWO-TIER BOARD FOR INDIA – THE CONCLUSION 54

I. BOARD STRUCTURE IN THE INDIAN CONTEXT

A. WHO ARE DIRECTORS?

Directors are professional individuals hired by the company to direct its affairs, yet they are not servants of the company, thereby excluding the possibility of any master-servant relationship. The Companies Act, 2013 (**"CA 2013"**) does not define their position. Section 2(13) of the erstwhile Companies Act 1956 provided that 'directors' includes any person occupying the position of a director by whatever name called, while Section 2(34) of CA 2013 merely provides that 'director' means a director appointed to the board of a company.

In this context, for understanding the true position of a director, it is relevant to understand the common law jurisprudence,[2] which is squarely applicable to the Indian context; directors are sometimes attributed as constructive trustees or managing partners. Such attributions do not change the true position of directors, that is, commercial individuals

[2] Coal Mining Co., Re, (1878) 10 Ch D 450.

managing a trading concern for the benefit of themselves and of all other shareholders in it.

Since the company cannot act on its own, the directors act as agents of the company and not as individual members.[3] The company delegates such powers to act on behalf of it, to the BOD by virtue of the resolution passed by the shareholders, and the maxim *delegatus non potest delegare* is applicable to the Board of Directors (**"BOD"**).[4] They contract in the name, and on behalf of the company, it is the company which is liable under the same and not the directors.[5] Further, directors are also deemed to be trustees – though not in the true sense of a trustee where the trustee is the legal owner of the trust property and contracts in his own name – of the company and not of individual shareholders.

B. SALIENT FEATURES OF BOD – IDENTIFICATION OF THE PROBLEM

The features of BOD could be simply put in an acronym – MESS; Multiple members on the board, Elected board, Separate from operational managers, and Separate from shareholders.[6] First, Multiplicity of members ensures mutual monitoring and prevents idiosyncratic decisions. This structure has evolved from a structure concentrating authority on a single trustee. It is also relevant to consider the fact that a one-person board can still exist in cases of small companies, where the functions of a board could be effectively discharged by a single elected director. This indicates that even though a supervisory mechanism on the board was conceived in the early days of imbibing corporate form, it is not popularly preferred even in recent times.

---

[3] Ray Cylinders & Containers v. Hindustan General Industries Ltd., AIR 1998 Del 418 (India).
[4] Steel Authority Of India v. Presiding Officers, Labour Court, (1980) 3 SCC 734 (India).
[5] Kuriakose v. PKV Group Industries, (2002) 111 Comp Cas 826 (India).
[6] REINIER KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH (3d ed. 2017) [hereinafter, KRAAKMAN ET AL.].

Second, elected board is an important aspect, and there could be no converse opinion on this. It is sufficient that the board is elected in substantial part, if not fully, by the shareholders. The objective of this aspect is that the directors remain responsive to the interests of the shareholders. While it is controversial whether the directors should be accountable only to the shareholders, there is scope for appointment of directors to take care of the interests of other stakeholders. However, do such appointments really achieve their purpose is a debatable point, and requires a separate study in itself which is beyond the scope of this paper.

Third, BOD being separate from operational managers is simply a formal matter of distinction spearheaded to check the quality of decision making, in those decisions which are generally approved by the BOD themselves, as opposed to those decisions requiring the approval of shareholders. Fundamentally, the separation depends upon the type of structure of the board; one-tier or two-tier board.[7] In India, the BOD cannot be strictly said to be a one-tier or two-tier, which would be discussed in detail in the forthcoming sections.

Fourth, BOD being separate from the shareholders is the fundamental reason which requires the existence of BOD. It is relevant to consider the scope of involvement of shareholders in the decision-making. While certain fundamental decisions pertaining to the business of the company will require the approval of the shareholders, their involvement in other decisions is restricted to economize the cost of the decision-making process. Be that as it may, it is imperative to understand the position of the supervisory board in these circumstances; whether it should restrict the involvement of shareholders or it should merely act as a supervisor to the BOD. Further, to what extent the power of supervision must be exercised is a point worth considering.

---

[7] Carsten Jungmann, *The Dualism of one-tier and two-tier Board Systems in Europe*, 3 EUR. CO. FIN. L. REV. 426 (2006).

C. STRUCTURAL ORGANIZATION OF BOARD OF DIRECTORS IN INDIA

A global understanding is that BOD should be elected by the shareholders.[8] While the CA 2013 does not directly state that the shareholders shall elect the BOD, it could be discerned from a combined reading of Section 152(2) Sections 96(1), 162 and Cl. 66(ii) in the Model AOA, that every director shall be appointed by the company in the general meeting . A plain reading of these provisions would mean that the directors are appointed by an election in the general meeting of the shareholders by a simple majority of votes.[9] The overall control and supervision of the affairs is delegated to the BOD by the shareholders.

The BOD is composed of executive, non-executive directors, and independent directors. Executive Directors (**"ED"**) are those who are in whole-time employment and are entrusted with day-to-day operations of the company whereas non-ED are those who are in part-time employment and do not routinely participate in the affairs of the company but participate in board meetings or committees. The ED appraise the non-ED about the affairs. It is seen that non-ED bring unbiased and independent views on BOD's deliberations on strategy, performance, management of conflicts and standards of conduct.

According to the specific roles they might perform in the company, these directors have duties distinct from each other. However, it is interesting to note that there is no distinction between Whole-time Director (**"WTD"**) or part-time director or appointed or nominated

[8] KRAAKMAN ET AL., *supra* note 5 at 13.
[9] AVTAR SINGH, COMPANY LAW 272 (17 ed., 2018) [hereinafter, SINGH].

director vis-à-vis their liability for acts of omission or commission, for they are all treated at par.[10]

Non-executive directors and independent directors are expected to provide impartial and independent advice to the company. They render professional guidance and assistance in the field of their expertise to keep moral pressure. They also keep an eye on executive directors to ensure that they do not misuse their authority by monitoring the performance of the company under the BOD, and finally balance the interests of company, shareholders, employees and directors.[11]

It is interesting to take note of board composition in certain notable companies in India. In Infosys, there are three executive directors, one among them is also the Chairman of the Board, and the other two are also operational managers in the company. There are six independent directors.[12] In Reliance Industries Ltd., there are five executive directors, five independent directors, and two non-executive directors. One of the executive directors is also the Chairman and Managing director.[13] Apart from these, both these companies have board committees like Audit, CSR & Governance, Stakeholders relationship committees, etc. which are dominated by independent directors.

While this may be true in large enterprises which find their place often in the NIFTY, almost 14% of the public companies in India are not even compliant with the board composition, let alone the reason of

---

[10] Madhavan Nambiar v. ROC, (2002) 108 Comp Cas 1 (Mad HC); Beejay Engineering Pvt. Ltd. In re., (1983) 53 Comp Cas 918 (Del); Jagjivan Hiralal Doshi v. ROC, (1989) 65 Comp Cas 553 (Bom HC).

[11] Code for Independent Directors; Companies Act 2013, Act No. 18 of 2013, sch.IV [hereinafter, Companies Act 2013].

[12] Board of Directors, Management of Profiles, INFOSYS, https://www.infosys.com/about/management-profiles.html [hereinafter, Infosys – Board of Directors].

[13] Board of Directors, RELIANCE INDUSTRIES LIMITED, https://www.ril.com/OurCompany/Leadership/BoardOfDirectors.aspx.

disadvantageous board composition for corporate governance. Of these, 55 companies are PSUs. And the number of compliant companies is decreasing from 2018 to 2020, particularly in the context of independent directors.[14]

D. OVERLAPPING FUNCTIONS

It is pertinent to note that directors so appointed to the board may hold other positions in the company. Cl. 77(ii) in the Model AOA[15] states that a director may be appointed as chief executive officer, manager, company secretary or chief financial officer. For instance, as noted in the previous sections, the Managing Director in Infosys is also the CEO, and the WTD is also the COO.[16]

Section 164 of CA 2013 provides for an exhaustive list of disqualifications for the appointment of directors. Holding an additional position in the company in the form of key managerial personnel (operational manager) is not prohibited. Section 196(3) of the Act provides an exhaustive list of non-eligibility criteria for the appointment of Managing Director (**"MD"**), Whole-Time Director or Manager, which does not prevent the directors from being appointed as Key Managerial Personnel (**"KMP"**) or vice versa.

Thus, it can be concluded that directors can hold dual capacities as a member of the BOD and manage the affairs of the company as MD or a KMP. Whilst an MD and Manager manage the whole or substantial affairs of the company, it is relevant to understand the difference between the two positions. An MD is a part of the BOD and not subordinate to it; he

---

[14] *Independent Directors: Indian companies slow in changing board composition, notes IiAS*, THE FINANCIAL EXPRESS, https://www.financialexpress.com/industry/independent-directors-indian-companies-slow-in-changing-board-composition-notes-iias/2251635/.

[15] Companies Act 2013, *supra* note 10, Table F, sch.1.

[16] Infosys – Board of Directors, *supra* note 11.

is not a servant of the company.[17] A Manager on the other hand, is a paid executive of the company, and is subject to the superintendence, control and directions of the BOD.[18]

According to Blackburn J, a manager is not an agent who is to do a particular thing, or a servant who is to obey orders, but a person who is entrusted with the power to transact the whole or substantial affairs of the company.[19] This idea is followed in the Indian courts also[20] but whether it holds well in the current scenario or not remains to be seen.

As discussed above, the directors do not have any legal impediment from holding a position as KMP, and it is acceptable that managers are not subservient to the BOD to the extent that such a manager is also a director in the BOD. Be that as it may, it is pertinent to note the legal impediments in discharging the functions, in dual capacities.

Cl. 78 of the Model AOA provides that

"*a provision of the Act or these regulations, requiring or authorising a thing to be done by, or to a director and chief executive officer, manager, company secretary or chief financial officer, shall not be satisfied by it being done by, or to the same person acting both as director and as, or in place of, chief executive officer, manager, company secretary or chief financial officer.*"

A plain reading of the above provision shows that an individual acting both as a director and KMP, should discharge these functions separately in their respective capacities. This clearly demarcates the position of the two roles notwithstanding the fact it is a one-tier board. It is also reasonable that the doctrine of constructive notice would be applicable.

---

[17] Ram Pershad v. CIT, (1972) 2 SCC 696 (India).
[18] SINGH, *supra* note 8 at 348.
[19] Gibson v. Barton, [1875] LR 10 QB 329.
[20] Basant Lal v. Emperor, AIR 1918 Lah 170, 171 (India).

The two categories of managerial personnel under section 197-A of the Old Act corresponding to 196 (1) of the New Act are— (1) managing director; and (2) manager. A company cannot simultaneously appoint a managing director as well as a manager. Section 269 (1) of the Old Act made it obligatory for a public company, or a private company which was a subsidiary of a public company, with a paid-up share capital of Rs. 5 crores or more to employ a managing or whole-time director (executive director) or a manager. Any company which did not fall within this category was to be managed by a BOD consisting entirely of ordinary (non-executive) directors.

Under Section 203 of the New Act read with Rule 8 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, every listed company and every other public company which has a paid-up share capital of Rs 10 crore or more is required to appoint whole-time key managerial personnel, namely,-(i) a managing director, or a Chief Executive Officer or a manager and in their absence, a whole-time director; (ii) a Company Secretary; and (iii) a Chief Financial Officer.

However, as per the first proviso to section 203 (1) of the New Act, unless the Articles of Association of a company provide otherwise, or such company does not carry multiple businesses, an individual cannot be appointed or reappointed to hold, the office of chairperson, and managing director or Chief Executive Officer of the company, simultaneously. This reflects the recommendation of the Sir Adrian Cadbury Committee on the Financial Aspects of Corporate Governance. It may be noted that as per the second proviso to Section 203 (1) of the New Act, the aforesaid first proviso does not apply to such classes of companies which have multiple businesses, and which have appointed one or more Chief Executive Officers for each of such business as may be notified by the Central Government.

In light of the above, it could be seen that there are indeed overlapping functions within the BOD in certain cases, and the same is

addressed by specific provisions in the CA 2013. The key takeaway is that such overlaps pave way for the segregation of functions within the BOD notwithstanding its one-tier nature.

II. SEGREGATION OF SUPERVISORY AND MANAGERIAL FUNCTIONS IN ONE-TIER BOARD

Segregation is important for having proper checks and balances. This could be analogised with the separation of powers doctrine in the Constitution.[21] The role of independent directors is noteworthy in this regard. The Code for Independent Directors provides that such directors determine appropriate levels of remuneration for executive directors, key managerial personnel and senior management and have a prime role in appointing, and wherever necessary in recommending the removal of executive directors, key managerial personnel and senior management.[22] This shows that the Independent Directors act as supervisors over the directors who discharge the managerial functions but not over the BOD in general.

The corporate governance regime in Germany has greatly influenced international corporate governance, which paved the way for the role of independent directors, not as advisors but as monitors of the board.[23] At the same time, there was a strong recommendation for replacing the one-tier system with a two-tiered one.[24] While Germany modernized its company law regime pertaining to business judgment rules, capital market regulation, takeover and insolvency, by incorporating ideas from France, UK and US (where one-tier systems are followed), it was , the segregation,

---

[21] Cary Coglianese, *Legitimacy and Corporate Governance*, 32 DEL. J. CORP. L. 159, 162 (2007).

[22] Companies Act 2013, *supra* note 10, sch IV, Cl. II(7).

[23] MELVIN A. EISENBERG, THE STRUCTURE OF THE CORPORATION: A LEGAL ANALYSIS 170–177 (Beard Books 2006) (1976).

[24] Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950-2005: Of Shareholder Value and Stock Market Prices*, 59(6) STAN. L. REV. 1465, 1563 (2007) [hereinafter, Gordon].

in the form of two boards, which was retained. Thus, the importance of segregation could be discerned.

The segregation of functions paves way for the convergence of two systems with the focus on independent directors.[25] In the US, the advisory board dominated by non-executive independent directors has developed into a monitoring board.[26] In this manner, it has been acknowledged that both the systems have been equally successful in the forward German Corporate Governance Code 2012 but later got omitted in 2013. While the reason for the same is beyond the scope of this paper, it is safe to conclude that convergence of the two systems is not impossible as is evident from the US experience.

III. BOD AND CORPORATE GOVERNANCE FAILURES

The objective of having multiple members in BOD is for mutual monitoring. Further, in India, some directors – independent directors - are appointed with the sole purpose of upholding good corporate governance. While there are independent directors in the BOD, they do not possess sufficient powers under the Act to discharge their functions to achieve the cardinal objectives for which they were conceived in the first place.

This is evident from the fundamental position that the decision of BOD shall be taken by a vote of majority unless expressly provided otherwise in the Act.[27] Furthermore, in case of a tie, the chairman – who is elected by the majority – will have a casting vote.[28] When the act has paved way for majoritarianism, there is only so much that could be expected from independent directors.

---

[25] KRAAKMAN ET AL., *supra* note 5. Cited in Marcus Roth, *Corporate Boards in Germany*, *in* PAUL DAVIES ET AL, CORPORATE BOARDS IN LAW AND PRACTICE - A COMPARITIVE ANALYSIS IN EUROPE 263 (2013) [hereinafter, ROTH].
[26] Gordon, *supra* note 23 at 1518.
[27] Companies Act 2013, *supra* note 10, sch. I, Table F, Cl. 68(i).
[28] Companies Act 2013, *supra* note 10, sch. I, Table F, Cl. 68(ii).

The consistent opinion of the courts is that distinction has to be made between directors who are on the board by virtue of their technical skill, and those who are in effective control of the management of the company.[29] It would be unreasonable to fasten liability on independent directors for defaults and breaches of the company, where such directors are appointed by virtue of their skill and experience, and do not participate in the management. This puts a burden on the non-ED to prove their non-involvement in any mishaps, which is a serious impediment to their performance. Moreover, a review of empirical studies and anecdotal evidence suggests that the independent director's regime is not effective.[30]

IV. TWO TIER BOARD STRUCTURE IN GERMANY

It was already pointed out in the introduction section that Germany follows two-tier system where there is a requirement of two boards in stock corporations (equivalent of a public company in the Indian context) with mandatory division of power between a supervisory and management functions as per the Sections 95-116 and 76-94 of the German Stock Corporation Act (Aktiengesetz) ("**the GSC Act**").[31]

---

[29] Indian Oil Corporation Ltd. v. The Chief Inspector of Factories and Ors., (1998) SCC (LS) 1433 (India); In Re: Beejay Engineers Pvt. Ltd. and Ors., (1983) 53 CompCas 918 (Delhi); Technical Consultancy House (P) Ltd. v. Kuldip Raj Narang and Ors., (1989) 66 CompCas 410 (Delhi); Security and Finance (P) Ltd. v. B.K. Bedi and Ors., (1991) 71 Comp Cas 101 (Delhi); Daewoo Motors India Ltd. v. H.D. Talwani (2012) DLT (CRL.) 238 (Delhi).

[30] Umakanth Varottil, *Evolution and Effectiveness of Independent Directors in Indian Corporate Governance*, 6 HASTINGS BUS. L. J. 281–375 (2010).

[31] BGBI (Federal Gazette) I 1089 (06.09.1965), English translation available at German Stock Corporation Act (Aktiengesetz), Global law firm, Norton Rose Fulbright, https://www.nortonrosefulbright.com/en/knowledge/publications/bc19a262/german-stock-corporation-act-aktiengesetz.

Moreover, board structure in Germany serves as a classic authority on the two-tier system.[32]

The function of control and supervision is given to the supervisory board, and the function of running the day-to-day affairs is directly given to the management board. The supervisory board cannot interfere in the management. However, it has the power to veto any decision of the management board. Moreover, they also have the duty to advise the management board. It is interesting to note that Chapter 3 of the German Corporate Governance Code emphasises on the cooperation of the two boards.

It is relevant to take note of the stakeholder approach – in the form of co-determination – in Germany for it has been vital in contributing to sustaining the two-tier system. The proposals[33] for a one-tier system have been turned down due to this approach.

As per Section 76 and 77 of the GSC Act, the responsibility of conducting the day-to-day functions necessary to run the business is exclusively given to the MB. As per Section 111(4), the SB has to respect this exclusivity, and it should not direct the MB to act in a particular manner be that as it may, the GCGC emphasises on the cooperation between the two boards so that it benefits the company. However, the SB reserves the power to approve certain transactions explicitly mentioned in the AOA or by itself. For example, consent of the SB is mandatory for strategy, closure, mergers and acquisitions, etc. However, there is also a

---

[32] Klaus.J. Hopt, *The German Two Tier Board: Experience, Theories, Reforms, in* HOPT ET AL (EDS.), COMPARATIVE CORPORATE GOVERNANCE – THE STATE OF THE ART AND EMERGING RESEARCH (Oxford Univ. Press 1998) 227; Jean du Plessis and Ingo Saenger, *The Supervisory Board as the Company Organ, in* JEAN DU PLESSIS ET AL, GERMAN CORPORATE GOVERNANCE IN INTERNATIONAL AND EUROPEAN CONTEXT 91 (2d ed. 2012) cited in ROTH, *supra* note 24.

[33] Resolution 19, Business Law Section, German Jurists Forum 2012.

minority view that SB should require consent only in cases of ostensible breach of duty by the MB.[34]

While supervision is the primary duty of the SB, the MB also mutually monitors.[35] In a sense, the MB also performs supervisory functions. But a member of the MB cannot be a member of the SB. The objective is to prevent the build-up of de facto BOD.[36] As a matter of fact, the SB was jurisprudentially seen as an independent and external body without the intervention of employees until the concept of co-determination was adopted.[37]

V. HARMONIZING THE PROS AND CONS OF THE BOARD STRUCTURES

The advantages of a one-tier board could be summarized as having better flow of information due to a greater number of meetings, and presence of expert committees; quick decision making as there is no need for separate approval; better understanding of, and high involvement in the business by the board since MD or CEO work along with the non-executive directors, thereby curbing the ex-post control on the management decisions.[38]

The presence of ED and non-ED does not really help in making and monitoring business decisions. In cases of a CEO being a director, it would be hard for the other directors to stand up to the dominance wielded by such a CEO. Independent directors may not function

---

[34] K.J. HOPT AND M. ROTH, GROBKOMMENTAR AKTG (4th ed, De Gruyter 2005) Section 111 no. 605-631.
[35] *Id.* at Section 93 no. 107.
[36] WERNER SHUBERT & PETER HOMMELHOFF, HUNDERT JAHRE MODERNES AKTG 461 (1985).
[37] M. Becht et al, *Corporate Law and Governance*, 2 *in* HANDBOOK OF LAW AND ECONOMICS 829, 877 (2007) [hereinafter, M. Becht et al,].
[38] Carsten Jungmann, *The Effectiveness of Corporate Governance in One-tier and Two-tier Board Systems—Evidence from the UK and Germany*, 3(4) EUR. COM. FIN. L. REV., 464, 426-474 (2006).

effectively if they hold executive directorship in other companies as they would want to spend most of their energy in the latter.[39] Moreover, it is possible that such independent directors may develop personal relationships with other directors which would pave way for bias.[40]

The advantages of two-tier boards include reduction of information asymmetry between the board and shareholders; checks and balances due to separation; responsiveness of the BOD to other stakeholders like employees.[41]

The BOD in a one-tier system is expected to be responsible for both monitoring management and participating in management decisions in the ordinary course of firm's business. This idea creates a fundamental and irreconcilable conflict between the two functions as the director is required to monitor themselves. Furthermore, in the US, it has been established that too much emphasis on monitoring tends to create a rift between non-executive and executive directors.[42]

VI. TWO-TIER BOARD AND INDIAN SCENARIO

While the law in India mandates a BOD, it does not require it to be one-tier. It is undeniable that most of the shareholding is closely held. One reason is that such companies have family-dominated shareholding.[43] Other reasons include concerted holding of shares for various commercial

---

[39] Grit Tüngler, *Anglo-American Board of Directors and the German Supervisory Board—Marionettes in a Puppet Theatre of Corporate Governance or Efficient Controlling Devices?*, 12(2) BOND L. REV., 264, 230-269 (2000).

[40] Antony Page, *Unconscious Bias and the Limits of Directors Independence*, U. ILL. L. REV. 237 (2009).

[41] David Block & Anne-Marie Gerstner, *One-Tier vs. Two-Tier Board Structure: A Comparison Between the United States and Germany* 1 COMPARATIVE CORPORATE GOV. FIN. REGULATION (2016) [hereinafter, Block & Gerstner].

[42] JONATHAN R. MACEY, CORPORATE GOVERNANCE—PROMISES KEPT, PROMISES BROKEN 54 (Princeton University Press, 2010).

[43] Jayati Sarkar & Subrata Sarkar, *Large Shareholder Activism in Corporate Governance in Developing Countries: Evidence from India*, 1 INT'L REV. FIN. 161, 168 (2000).

or non-commercial factors. When this is the situation, it is highly likely that the board in general would be dominated by representatives of such shareholders.

They tend to become constructive agents of the individual shareholders which is contradictory to the position of directors. If we would want a two-tier structure, the manner of implementation is a complex process as it might increase the operational costs.

The managerial board might not be responsive to the shareholders, whereas the utility of an elected board is to attain shareholder-protective business administration. But this proposition is based on the shareholder primacy theory, which itself is not free from criticisms, and it is necessary to weigh the pros and cons which is beyond the scope of this paper.

The table below makes a comparison of the function of a supervisory board with the functions performed by the BOD in India.

Supervisory Board in Germany	**Independent directors/non-Executive directors**	**Executive directors**	**Provisions in CA 2013**
Control the business affairs - **Sec. 111(1) & (4) of GSC Act**	No	Yes	166
Advise the management board – **GCGC**	Yes	No	Sch. IV
Appoint and dismiss members of	No	Yes	152

the management board – **Sec. 84**			
Propose the name of auditors to be appointed in GM – **Sec. 124(3)**	No	Yes	139
Prepare the agenda for the GM – **Sec. 124**	No	Yes	149
Responsible for the financial statements – **Sec. 171**	Yes	Yes	164(2)

Apart from the executive directors of the board, the day-to-day affairs of the company are looked after by the KMP. A company may appoint a CEO instead of a MD or a WTD. While the MD or WTD has to be in the BOD, a CEO is merely an employee. It is also interesting to note that a director can also be appointed as a CEO, thereby having dual capacities.[44]

The one-tier system in India is starting to reflect the desirable feature of a two-tier system. For example, the audit committee has to necessarily be dominated by independent directors,[45] thereby marginalizing the effect of other directors who may not have sufficient expertise or bonafides.

[44] SINGH, *supra* note 8.
[45] Companies Act 2013, *supra* note 10, § 177(2).

VII. TAILORING TWO-TIER BOARD FOR INDIA – THE CONCLUSION

The two systems reflect different historical background and national policies.[46] India has been striving towards independence rather than concentrating on particularly embracing any theories of corporate governance. However, such independence is not achievable as it stands due to certain structural flaws as pointed in this paper.

The problem of strengthening the position of independent directors has been identified long back which has reference even in the Cadbury Committee report.[47]It is not the idea of this paper to advocate the two-tier system. In two-tier system, there is no contact between investors and supervisory directors, which is impossible to implement in India owing to the prevalence of promoter controlled companies. Convergence could be achieved in India by prohibiting directors from becoming a KMP, which would ideally contribute to the independence that is sought to be achieved in the Indian context.

What India could learn from US which also follows the one-tier system is to have separate meetings for independent directors.[48] This arrangement is contrary to the conventional understanding of a one-tier board system. However, this enables the convergence of the two systems so that India could benefit from it greatly.

---

[46] Gordon, *supra* note 23 at 282.
[47] M. Becht et al, *supra* note 36.
[48] Block and Gerstner, *supra* note 40.

SHORT-TERMISM IN INDIA: TOWARDS A SUSTAINABLE CORPORATE GOVERNANCE MODEL

*Abhinav Gupta & Madeeha Arshad**

ABSTRACT

The principles of corporate governance have over the years been embedded in the legal framework of India. A long-term approach towards the management of the company is arguably an essential element of corporate governance. On the other hand, short-term governance or short-termism, focuses unduly on the quarterly profits of the company at the cost of a sustainable long-term development. In this paper, we explore the concept of short-termism from an Indian perspective. The paper proceeds with the analysis of the relationship between short-termism and corporate governance. Thereafter, it engages in an empirical study in order to assess the presence of short-termism as well as its level of penetration in the Indian market. The consequences of such a presence of short-termism are then explored by the paper. Lastly, the paper suggests various legislative and policy-oriented recommendations, which can serve to bolster long-termism in the Indian corporate law structure.

Keywords: corporate governance, short-termism, listed companies, director's duties.

TABLE OF CONTENTS

I. INTRODUCTION 56
II. CORPORATE GOVERNANCE AND SHORT-TERMISM 59
III. ASSESSING THE EXISTENCE OF SHORT-TERMISM IN INDIA 63

* The authors are fourth year students at West Bengal National University of Juridical Sciences.

IV. CONSEQUENCES OF SHORT-TERMISM UNDER THE INDIAN LANDSCAPE 71
V. RECOMMENDATIONS: TACKLING SHORT-TERMISM IN INDIA 79
VI. CONCLUSION 94
VII. ANNEXURE – I 95

I. INTRODUCTION

The idea of sustainable economic development is based on the rapid degradation of the environment and the drainage of natural resources.[1] It has rapidly become the primary objective of various nation-states and the international community – most famously through the passage of the United Nations Sustainable Development Goals.[2] In this regard, the corporate sector arguably plays a vital role in the development of such a sustainable ecosystem.[3] The notion of sustainable development, therefore, requires the corporate sector to channel funds and resources that align with the vision of such a sustainable economy.[4] Thus, a policy towards sustainable corporate governance finds immense importance in this regard.[5]

---

1 Edward B. Barbier, *The Concept of Sustainable Economic Development*, 14(2) ENVIRONMENTAL CONSERVATION 101, 102 (1987).
2 Department of Economic and Social Affairs, *The 17 Sustainable Development Goals*, UNITED NATIONS https://sdgs.un.org/goals.
3 Steven N. Kaplan, *Are US Companies Too Short-Term Oriented? Some Thoughts*, 18 INNOVATION POLICY AND ECONOMY 107, 107-108 (2018).
4 Malgorzata Janicka et al., *Does Short-Termism Influence the Market Value of Companies? Evidence from EU Countries*, 13(11) JRFM 272, 273 (2020).
5 *Id.* at 272-273.

Short-termism, which refers to the objective of the company to obtain immediate profits at the cost of its long-term functioning, [6] has been widely argued to be inconsistent with the objectives of sustainable corporate governance.[7] The earliest work and the identification of this problem can be traced back to an article authored by Martin Lipton in 1979.[8] The problem of short-termism has been identified worldwide in countries such as the United States of America,[9] the United Kingdom,[10] and Singapore.[11] Hence, no nation-state has been effective in tackling and overcoming this issue of short-termism.

The objective of this paper is to throw light on, and recommend certain policy measures that can assist in alleviating short-termism in India. Short-termism in the Indian context is almost completely unaddressed by scholars and the available literature on the same is limited.[12] Therefore, in order to bridge this research gap, we analyze the concept of short-termism in the Indian context, and extensively cover its evidence of existence, consequences, causes as well as possible solutions to the same. Herein, it is also important to highlight that short-termism

---

[6] Beatriz Pessoa de Araujo, *The Modern Dilemma: Balancing Short and Long-Term Business Pressures*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE, (Jun. 20, 2019) https://corpgov.law.harvard.edu/2019/06/20/the-modern-dilemma-balancing-short-and-long-term-business-pressures/ [hereinafter, Araujo].
[7] *Id.*
[8] Martin Lipton, *Takeover Bids in the Target's Boardroom*, 35(1) THE BUSINESS LAWYER 101 (1979).
[9] Razeen Sappideen, *Focusing on Corporate Short-Termism*, SING. J. L. S. 412 (2011).
[10] Department for Business Innovation & Skills, *A Long-Term Focus for Corporate Britain: A Call for Evidence*, GOV. UK (Oct. 25, 2010) https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/31563/10-1225-long-term-focus-corporate-britain.pdf.
[11] Ivan Tan Ren Yi, *The Future of ESG in Singapore*, 11 SINGAPORE LAW REVIEW 1 (2019).
[12] For literature on short-termism in the Indian context, *see also* Atul Pandey & Satish Padhi, *Governance of Corporations: Long-Term Approach vs. Short-Term Approach*, FORTUNE INDIA (Aug. 21, 2018) https://www.fortuneindia.com/opinion/governance-of-corporations-long-term-approach-vs-short-term-approach/102300; R. Shankar Raman, *Quarterly Earnings, Short and Long-Termism: A Fine Line*, BLOOMBERG (Aug. 31, 2018)https://www.bloombergquint.com/opinion/quarterly-earnings-short-and-long-termism-a-fine-line.

should not be conflated with the shareholder theory. It is argued that shareholder theory only focuses on giving primacy to the shareholders over other stakeholders, and motivates the corporations to maximise the profits accruing to their shareholders.[13] Though shareholder theory may be an element of short-termism, the latter concept is wider and focuses on the short-term profits and policies of the company that can also result from short-term investments and other measures.[14]

In Part II of this paper, we will focus on the basic concepts of corporate governance and short-termism. After identifying the elements of these concepts, we will proceed to analyze the relationship between the two. Thereafter, under Part III, the paper undertakes a preliminary inquiry regarding the existence of short-termism in India. Though certain committee reports have in the past have recognized that short-termism indeed is present in the country, the paper offers an empirical assessment of the most recent trends in short-termism. This actively contributes by examining the growth and the penetration of short-termism in the country's corporate sector.

The consequences of such short-term practices are then highlighted in Part IV of the paper. Herein, we will focus on the economic, social and the environmental impact that short-termism has in India as well as the world in general. The paper thereafter under Part V will focus on the core recommendations that we will make for dealing with the crucial issue of short-termism. It, herein, will provide legislative and policy-oriented recommendations with respect to the duty of the directors, the boards of

---

[13] Accounting Tools, *Shareholder Theory Definition*, AT (May 9, 2022) https://www.accountingtools.com/articles/shareholder-theory#:~:text=Shareholder%20theory%20is%20the%20view,possible%20return%20on%20their%20funds.

[14] Eunsup Daniel Shim, *Sustainability, Stakeholder Perspective and Corporate Success: A Paradigm Shift*, 4(5) INTERNATIONAL JOURNAL OF BUSINESS, HUMANITIES AND TECHNOLOGY 64, 65-66 (2014).

the companies, institutional investments, and sustainable corporate governance in India. Part VI of the paper offers concluding remarks.

II. CORPORATE GOVERNANCE AND SHORT-TERMISM

In this part, we intend to discuss the concepts of short-termism and corporate governance, and thereby highlight the relationship between them.

A. CORPORATE GOVERNANCE

With the advent of the 19th century, registered companies developed the ability to accommodate large scale investment while subjecting investors to minimum risk.[15] In India, the apace nature of globalization and liberalization prompted companies to introduce effectual corporate governance policies.[16] This evolution in the corporate sector warranted the need for a special team of corporate managers who were independent of the shareholders in order to incorporate and ensure accountability and responsibility in the framework.[17] The requirement for separate ownership and management arose primarily due to the fact that management would otherwise be cumbersome for large-scale companies, owing to its vast number of shareholders.[18]

Furthermore, given that companies resort to public offering of shares to meet their capital needs, this could lead to situations where the shareholders do not have the requisite understanding and expertise to operate a large-scale company.[19] Thus, it is this separation of the

---

[15] Shreeparna Dutta, *Emergence and Development of Corporate Governance in UK, USA and India*, 6(2) INDIAN JOURNAL OF LAW AND JUSTICE 72, 72 (2015) [hereinafter, Dutta].
[16] Ananyaa Jha & Aayush Kanojia, *Globalisation and Corporate Governance in Indian Context*, 3(5) INTL J. LAW MAN. & HUMAN. 482, 485-486 (2020).
[17] Dutta, *supra* note 15 at 74.
[18] *Id.* at 72.
[19] *Id.*

management from the shareholders which gave rise to concerns of accountability and thereby became the premise of modern day corporate governance.[20] The Organisation for Economic Co-operation and Development ("**OECD**") defines corporate governance as "a set of relationships between a company's management, its board, its shareholders and other stakeholders and provides the structure for setting objectives, determining means of attaining them and monitoring performance of the company".[21] Therefore, good corporate governance safeguards the interest of all the stakeholders involved such as the shareholders, creditors, consumers, the government and the society at large, by ensuring that the management fulfils its responsibility.[22]

It was recognized that implementing good corporate governance can help the company minimize the risk of malpractices, improve accountability and expedite the decision-making process within the company, thereby increasing operational efficiency. Importantly, it aims to further the interests of various stakeholders through principled and transparent means, so as to establish the organisation as a responsible corporate citizen.[23] This promotion of interest is regardless of whether it leads to an improvement in financial performance or not.[24] In other words, the duty of the directors and the management is not to achieve the maximum profits, but to balance the interests of various stakeholders.[25] This idea is termed as corporate social responsibility which forms an

---

[20] Vivek Sadhale, *Corporate Governance. The Situation in India Compared to Other Countries with Specific Reference to Corporate Governance in the UK*, 2(6) INTERNATIONAL IN-HOUSE COUNSEL JOURNAL 675, 675 (2009).
[21] Organisaiton for Economic Co-operation and Development, *G20/OECD Principles of Corporate Governance*, OECD (2015) https://www.oecd.org/daf/ca/Corporate-Governance-Principles-ENG.pdf.
[22] Dutta, *supra* note 15.
[23] Atul Mehrotra, *Corporate Governance, SEBI & Corporate Laws*, 90(4) THE CORPORATE LAWS WEEKLY157, 157 (1997).
[24] Martono Anggusti et al., *Corporate Governance for Employee's Welfare*, 3(3) INTL SOC. SCI. STUD 257, 258 (2015).
[25] *Id.*

integral component of corporate governance.[26] A good corporate governance model can also be beneficial in ensuring compliance with the applicable provisions of law and thus averting exorbitant litigation fee.[27] Moreover, for an emerging market like India, corporate governance is especially significant as it can not only reduce financial instability but also positively impact a company's reputation thereby making it more appealing to investors.[28]

Prior to the implementation of Companies Act, 2013 ("**the Act**"), corporate governance was primarily being governed by Clause 49 of the Listing Agreement.[29] However, with the introduction of the Act several provisions and regulations have been put in place to ensure smooth and effective corporate governance. For instance, the Act has codified the duties of the directors under §166. Other significant changes include the amendments to the composition of the board of directors, and the discontinuation of treating nominee directors as independent directors, to name a few.[30] Moreover, the Act mandates that directors of a company to promote the objects of the company in good faith for the betterment of its stakeholders – the company, its shareholders, employees, the society and the environment.[31]

---

[26] Mauricio Andres Latapi Agudelo, *A literature review of the history and evolution of corporate social responsibility*, 4(1) INTL. J. CORPORATE SOC. RESPONSIBILITY1, 1-2 (2019).
[27] Afra Afsharipour, *The Promise and Challenges of India's Corporate Governance Reforms*, 1 INDIAN JOURNAL OF LAW & ECONOMICS 33, 61 (2010).
[28] Dr. QaziMohd. Usman, *Corporate Governance and its Efficacy in Present Era*, 2 JAMIA LAW JOURNAL 61, 62-63 (2017).
[29] *Id.*
[30] Nishith Desai Associates, *Companies Act, 2013: Greater Emphasis on Governance through the Board and Board Processes*, LEXOLOGY (Jun. 4, 2014)https://www.lexology.com/library/detail.aspx?g=259ba402-8b1d-48ee-837e-63261752aef1 [hereinafter, Desai Associates].
[31] The Companies Act, No. 18 of 2013, §166(2) (Ind.).

B. SHORT TERMISM

For almost half a century, the general trend had been to laud and reward corporations for generating profits for their shareholders.[32] However, in the recent times, there has been a paradigm shift in the views of significant members of the corporate sector, whereby the idea that maximizing profitability and returns may be contradictory to the interests of the company in the long haul has been propounded.[33]

The Chartered Financial Analyst Institute ("**CFA**") has defined corporate short termism as "an excessive focus on short-term results at the expense of long-term interests".[34] As per the suggestions of CFA, a company endangers its strength as well as its shareholder returns by targeting shorter terms. In its 2020 report 'Short-Termism Revisited', the CFA has observed an inter-linkage between poorer returns in a span of over three to five years and underinvestment in Research and Development ("**R&D**") in addition to other general, capital and administrative expenditures.[35] The report encourages companies to adopt a long-term oriented approach wherein there is active engagement with investors and the environmental, social and governance ("**ESG**") standards are observed.[36]

Certain reasons for curbing short-termism have been identified. The Principles of Responsible Investment along with the United Nations

---

[32] David A. Katz et al., *The Long Term, The Short Term, and The Strategic Term*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE (Sept. 27, 2019) https://corpgov.law.harvard.edu/2019/09/27/the-long-term-the-short-term-and-the-strategic-term/ [hereinafter, Katz].
[33] *Id.*
[34] Chartered Financial Analyst Institute, *Report on Short Termism*, CFA, https://www.cfainstitute.org/en/advocacy/issues/short-termism#sort=%40pubbrowsedate%20descending.
[35] Matt Orsagh et al., *Short Termism Revisited – Improvements Made and Challenges Ahead in Investing for the Long Term*, CHARTERED FINANCIAL ANALYST INSTITUTE (Sept. 2020) https://www.cfainstitute.org/en/advocacy/policy-positions/short-termism-revisited.
[36] *Id.*

Global Compact released a report wherein they observed that the practice of short-termism deviates from the established UN Sustainable Development Goals.[37] It also concluded that the same could divert the attention of the corporate leaders from the integral corporate governance principles, and in turn distract them from the ESG considerations, while also curtailing innovation and limiting market opportunities.

III. ASSESSING THE EXISTENCE OF SHORT-TERMISM IN INDIA

The Narayana Murthy Committee Report on Corporate Governance, 2003, was arguably the first authoritative source that highlighted the presence of short-termism in the Indian corporate governance structure.[38] Thereafter, the Uday Kotak Committee Report on Corporate Governance, 2017, ("**the Report**") further implored on this crucial issue.[39] The Report states that the excessive emphasis on short-term performance instead of a long-term performance of a company, is a global trend that is also present in India.[40] Herein, as per the Report, many companies and their boards devote huge resources in order to fulfil their quarterly goals, instead of chasing long-term plans.[41] The Report noted that the fulfillment of long-term goals is one of the major roles of a company and essential to structure a resilient corporate governance framework.[42]

However, there is a lack of evidentiary basis with respect to an empirical assessment of the presence of short-termism in India. To the

---

[37] The United Nations, *Principles of Responsible Investment, Coping, Shifting, Changing 2.0*, UN(2017)https://www.unglobalcompact.org/library/5421.
[38] Securities and Exchange Board of India, *Consultative Paper on Review of Corporate Governance Norms in India*, SEBI (Mar. 21, 2003)https://www.sebi.gov.in/sebi_data/attachdocs/1357290354602.pdf.
[39] Securities and Exchange Board of India, *Report of the Committee on Corporate Governance*, SEBI(Oct. 5, 2017)https://www.sebi.gov.in/reports/reports/oct-2017/report-of-the-committee-on-corporate-governance_36177.html.
[40] *Id.* at 5.
[41] *Id.*
[42] *Id.* at 6.

date of writing, there is a lacuna in the statistical and empirical assessment of the extent of short-termism in the country. Resultantly, the paper in this part attempts to bridge this research gap as done below.

A. RESEARCH METHODOLOGY

The paper analyses the publicly available data of thirty listed companies to identify short-termism. The companies are selected from the Sensex 30 list which is based on the objective performance of the companies in the market and includes factors such as a healthy balance sheet, revenue margins, and market share.[43] Hence, it also becomes more crucial for these companies to follow long-term corporate governance goals in order to further grow their organization. The full list of these thirty companies has been displayed under Annexure-I in Part VII.

The research methodology adopted in this part is of statistical analysis. This methodology is used to investigate trends, patterns, and relationships through the use of qualitative data.[44] Statistical analysis a tool used by governments, scientists, and other organisations, and is viewed as an important research methodology.[45] Similarly, legal scholars have also utilised this methodology to provide empirical analysis regarding legal texts such as cases and other decisions, to name a few.[46]

In this paper, we will analyze the dividend pay-out of said thirty companies, over the course of the last five financial years beginning from

---

[43] Equity Master, *List of BSE Sensex 30 Companies*, EQUITY MASTER(Feb. 25, 2022) https://www.equitymaster.com/india-markets/bse-replica.asp; For an assessment of the factors of the Sensex 30 list, *see also* Corporate Finance Institute, *Sensex*, CFI(Sept. 10, 2016) https://corporatefinanceinstitute.com/resources/knowledge/trading-investing/sensex/.

[44] Scribbr, *The Beginner's Guide to Statistical Analysis*, SCRIBBR, https://www.scribbr.com/category/statistics/#:~:text=Statistical%20analysis%20is%20the%20main,characteristics%20of%20a%20data%20set.

[45] *Id.*

[46] For instance, *see* Jonathan Kastellec, *The Statistical Analysis of Judicial Decisions and Legal Rules with Classification Trees*, 7(2) J. EMPIRICAL LEGAL STUDIES 202, 202-230 (2010).

FY 2016-2017 to FY 2020-2021. Herein, the interpretative method of content analysis permits us to examine hundreds of decisions based on hypothesis that could not have been achieved with other methodologies. To calculate the dividend payout, we rely on the secondary data method, by finding information from Equity Master – a webpage collecting various market related data of Indian companies since 1996.[47] Herein, we look at the factsheet of the companies to collate data from the last five financial years.[48]

There are certain limitations to our study that need to be highlighted. *First*, the study ranges for only the immediately preceding five financial years and does not cover prior years due to the lack of available data. However, such a limitation in our opinion is inconsequential since our broad goal is to showcase the rise in short-termism in India – which can be achieved from a five-year dataset. *Second*, with respect to the sectoral wise analysis that has been conducted, it is important to note that the said analysis only comprises the companies that are there under the Sensex 30 list; and a specific analysis on other companies falling under these sectors has not been conducted.

B. FACTORS FOR ASSESSING SHORT-TERMISM

Over the years, scholars have provided different indicators for assessing the existence and the extent of corporate short-termism in the corporate sector. One of the widely utilized indicators is the assessment of the evolution, with respect to the amount of the net corporate funds utilized for the pay-outs to the shareholders in the form of dividends, as contrasted with the change in the amount used in investments by the

[47] Equity Master, *Equity Master – The Investor's Best Friend*, EQUITY MASTER (1996) https://www.equitymaster.com/.

[48] Equity Master, *Indian Stock Market Research*, EQUITY MASTER, https://www.equitymaster.com/stock-research/?utm_source=submenu.

company.[49] This is based on the rationale that increasing expenditure on dividend pay-outs indicate the approach of the company to engage in short-term goal achievement, instead of a long-term corporate sustainable approach that is indicated from investments.[50] It is important to note that there exists no strict threshold on the basis of which a person can state that there is an excessive focus on short-termism. Instead, the concept is measured over a period of time with an upward rise stipulating a growth in short-termism.[51]

A hypothesis herein exists under this approach. Many scholars such as William Lazonick and Mary O'Sullivan have proposed that companies either utilise their net income to invest in the future or fund its shareholders, thereby indicating that an increase in the shareholder pay-outs results in the decrease of the available resources to invest.[52] Lazonick and O'Sullivan have suggested that the rise in the obsession towards shareholder value has led to the strategy of "downsize and distribute", instead of "retain and invest".[53] In other words, when companies distribute large amounts towards their dividend, they are left with little resources for investments in research and development.[54] Therefore, we can observe that there exists an inverse relationship between the amount spent on dividend pay-outs and the amount utilised for investments.

In the current study, we analyse the corporate pay-outs to the shareholders in the form of dividends, which are the sums paid to the

---

[49] Beate Sjafejell et al., *Shareholder Primacy: The Main Barrier to Sustainable Companies* in B. RICHARDSON & BEATE SJAFEJELL, COMPANY LAW AND SUSTAINABILITY: LEGAL BARRIERS AND OPPORTUNITIES 75(Cambridge, 2015); Heitor Almcida et al., *The Real Effects of Share Repurchases*, 119 Journal of Financial Economics 168, 168-185 (2015).
[50] *Id.*
[51] *Id.*
[52] William Lazonick & Mary O'Sullivan, *Maximising Shareholder Value: A New Idealogy for Corporate Governance*, 29(1) ECONOMY AND SOCIETY13, 13-35 (2000).
[53] *Id.*
[54] William Lazonick, *The US Stock Market and the Governance of Innovative Enterprise*, 16(6) INDUSTRIAL AND CORPORATE CHANGE 983, 983 (2007).

shareholders from the profits. Resultantly, based on the above discussion, any form of increase in the aggregate dividend pay-out would indicate the decrease in the funds available for investments, and thus highlight the rise in short-termism.

Hence, we analyse the development of dividend pay-out of the thirty identified listed companies in Annexure-I, over a course of five years. The dividend pay-out is analysed in ratios in order to eliminate any effect of inflation and the individual growth of an organisation over a period of time. Thus, the analysis is based on the dividend pay-out ratio ('DPR'). The most common method to determine DPR is to divide the total paid dividends by the net income of the company.[55] However, due to the lack of publicly available information about the same for all the thirty companies, we have resorted to another method to calculate DPR which is by dividing the dividends per share by the earnings per share of the company.[56]

C. FINDINGS OF THE STUDY

The dataset with respect to the DPR for five financial years for the thirty identified companies is compiled under Annexure-I. It can be viewed that there has been an increase in the pay-outs for shareholders from FY 2016-2017 to FY 2020-2021, with the companies showing an upward trend. Individually, the companies have showcased an increase in the DPR over the years as shown below in Figure 1.

---

[55] Investopedia Team, *How to Calculate the Dividend Payout Ratio from an Income Statement*, INVESTOPEDIA (Apr. 29, 2021) https://www.investopedia.com/ask/answers/012015/how-do-i-calculate-dividend-payout-ratio-income-statement.asp.

[56] Corporate Finance Institution, *Dividend Payout Ratio*,CFI,https://corporatefinanceinstitute.com/resources/knowledge/finance/dividend-payout-ratio-formula/.

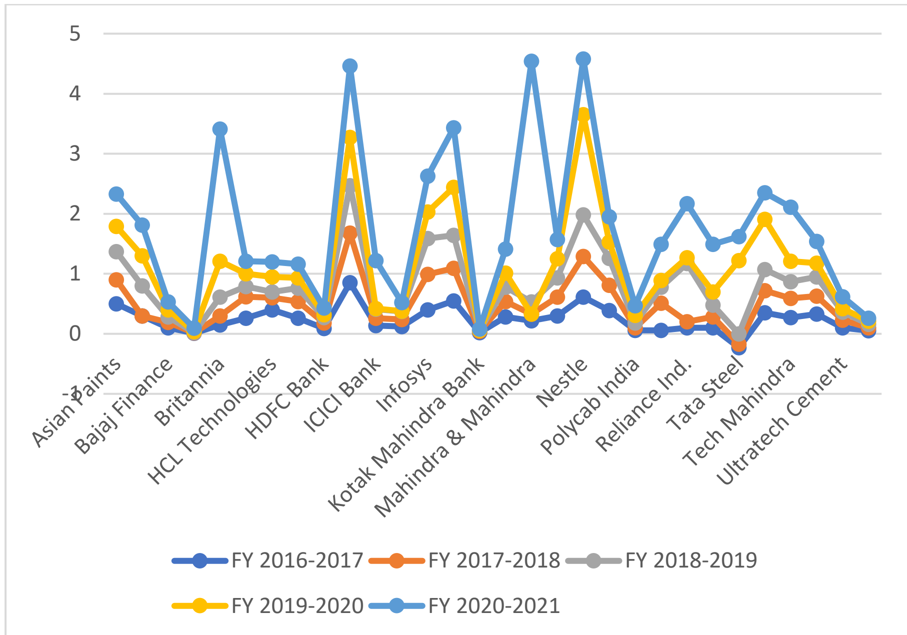

Figure 1: Company Wise DPR Growth

In addition to this individual increase, the total average DPR in terms of the percentage of revenue has increased exponentially from 23.7% in FY 2016-2017 to 61.1% in FY 2020-2021, as highlighted in Figure 2 below. Significant increase in the DPR of certain companies such as Mahindra & Mahindra, Britannia, Tech Mahindra, and Reliance Ind., to name a few, are the primary drivers behind this growth. There is a noticeable rise in the growth during the FY 2020-2021 which can be attributed to the COVID-19 pandemic wherein companies resorted to higher dividend pay-outs and the DPR increased dramatically to 61.1%.

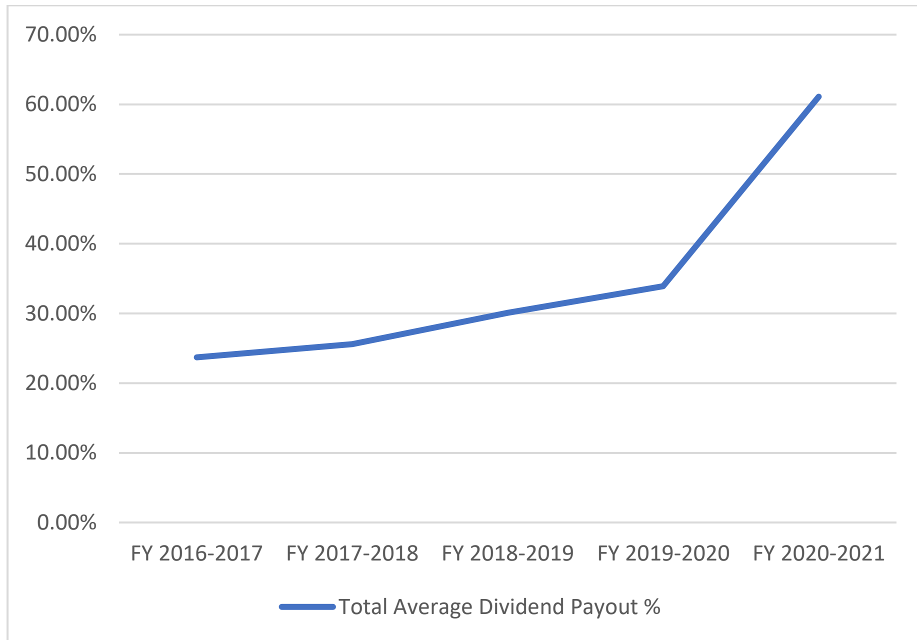

Figure 2: Growth in Total Average Dividend Payout (%)

The evolution of the DPR indicates the high penetration of short-termism pattern amongst the listed companies in India. The DPR during FY 2019-2020 stabilized to a certain degree before increasing steeply again in FY 2020-2021 during the pandemic.

Under the sector wise analysis as conducted under Figure 3, all sectors have shown an increase in the DPR over the years. Notably, the Food & Beverage, FMCG, and the Pharma sectors have showcased a steep rise in the DPR. The Food & Beverage sector has witnessed the most sustained increase over the last half a decade. Further, though the Auto sector has also seen a steep rise, in FY 2020-2021, the same is attributed to only one company, i.e. Mahindra & Mahindra.

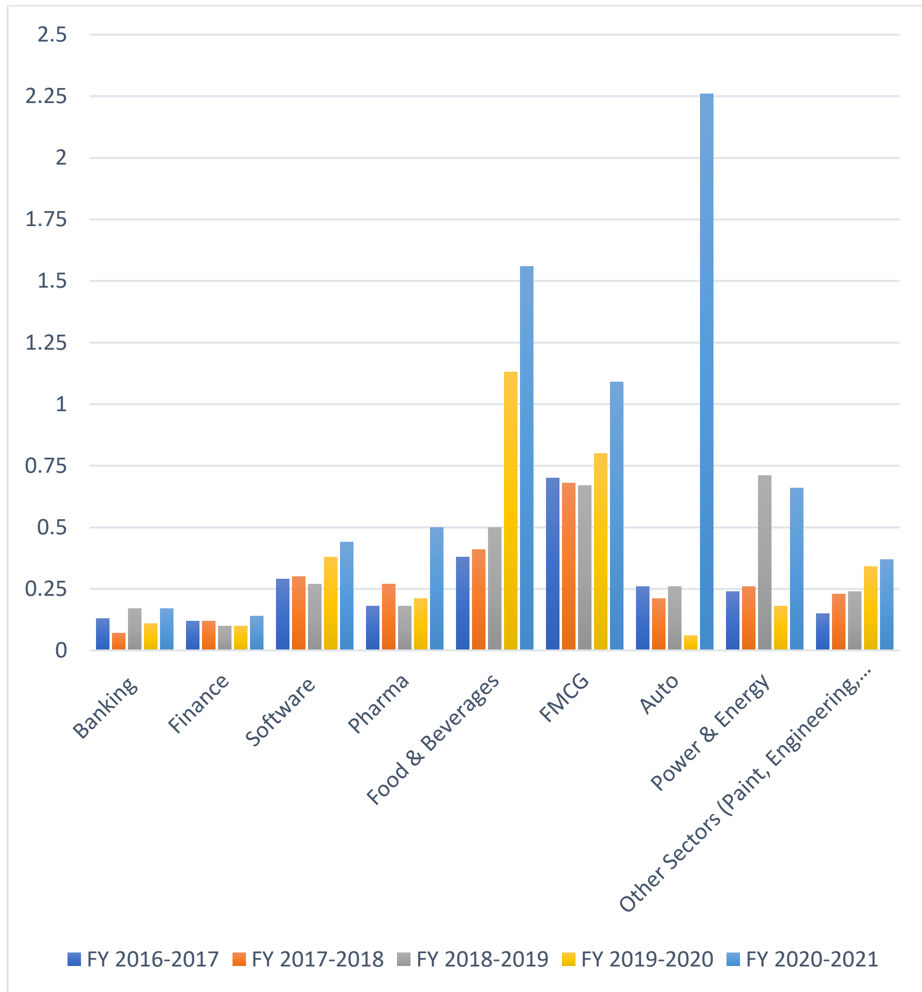

Figure 3: Sector Wise DPR Growth

The study has therefore showcased that the DPR amongst the thirty listed companies has increased significantly on average during the last five FYs. As per the hypothesis presented earlier, this indicates that the companies have less funds for long-term investments. These indicators fulfil the requirement of short-termism, and the study highlights a steep increase in the same. Thus, the companies are increasingly becoming more

focused on satisfying the short-term profits for the company, instead of making rationalised long-term investments that enable the proper operation of corporate governance. Hence, despite the limitations highlighted before, our study contributes by highlighting the sectoral and overall increase in short-termism in the Indian corporate governance framework.

IV. CONSEQUENCES OF SHORT-TERMISM UNDER THE INDIAN LANDSCAPE

This part focuses on the adverse results that are caused due to the short-term practices of the company, with respect to the environment, the economy, and the social sphere. Herein, consequences from both the Indian and the general worldwide perspective are highlighted.

A. ENVIRONMENTAL

The correlation between corporate short-termism and sustainability issues of a company has been recognised in corporate jurisprudence.[57]Further, there has also been a direct identification of the connection between short-termism and climate change.[58] The important factor for this is attributed to the practice of shareholder primacy.[59] In a study conducted by Professor Beate Sjåfjell, it was discovered that despite the scope provided by company law to incorporate environmentally conscious considerations while making business decisions, boards usually refrain from the same.[60] In fact, conversely, it has been seen that the operation of the board is restricted by the pervading standard of

---

[57] Araujo, *supra* note 6.
[58] N. Slawinski et al., *The Role of Short-Termism and Uncertainty in Organisationsal Inaction on Climate Change: Multilevel Framework*, 56(2) BUSINESS AND SOCIETY 253, 253-254 (2017).
[59] *Id.*
[60] Beate Sjåfjell, *Beyond Climate Risk: Integrating Sustainability into the Duties of the Corporate Board*, 23 DEAKING LAW REVIEW 1, 8 (2018).

shareholder primacy.[61] This is because the norm of shareholder primacy postulates that the board and members of senior management are 'agents' of the shareholders and thus obligated to maximise returns to them.[62]

In the context, it is important to note the 'planetary boundaries' proposed in 2009, that characterise "safe operating space" for mankind on Earth.[63] Out of these nine specified planetary boundaries, four of them – biodiversity, biogeochemical cycles of phosphorus and nitrogen, land system change and climate change – have been violated or are at the risk of being violated as a ramification of human production and consumption.[64] These violations could culminate into a situation where the planet would be transformed into an inhabitable place for humans. Furthermore, two of the aforementioned boundaries – biodiversity and climate change – are regarded as crucial boundaries, and therefore, a violation of either of them is sufficient to disturb the stability of the ecology.[65] As per the Intergovernmental Science-Policy Platform on Biodiversity and Ecosystem Services,[66] these violations are an outcome of the undertakings of certain sectors, like the practice of intensive agriculture, which entails extensive use of agrochemicals that poorly affects the natural and semi-natural habitats. The violations can also be attributed to hydropower plants and water abstractions that affect the biodiversity of freshwater bodies.[67]

---

[61] IncNow, *What is Shareholder Primacy, and Why does it Matter?*, INCNOW (Jan. 5, 2022) https://www.incnow.com/blog/2022/01/05/what-is-shareholder-primacy/.
[62] *Id.*
[63] Johan Rocktrom, *Planetary Boundaries: Exploring the Safe Operating Space for Humanity*, 14(2) ECOLOGY AND SOCIETY472, 472-473 (2009).
[64] Will Steffen, *Planetary Boundaries: Guiding Human Development on a Changing Planet*, SCIENCE (Jan. 15, 2015) https://www.science.org/doi/10.1126/science.1259855.
[65] *Id.*
[66] IPBES, *Intergovernmental Science- Policy Platform on Biodiversity and Ecosystem Services for Europe and Central Asia*, IPBES (2018) https://ipbes.net/assessment-reports/eca.
[67] *Id.*

Furthermore, the production of premium quality goods like coffee, cotton and cocoa exerts an immense amount of pressure on land as well as water resources and leads to a spike in the usage of agrochemicals and fertilisers.[68] The chemical pollution caused as a consequence of these industrial practices exposes the health of man and the environment to toxicities thereby jeopardising their life. It is worth noting that according to the projections of the OECD,[69] the consumption of raw materials in the world is expected to almost double by 2060 considering the expansion of the economy and improvements in the standard of living.[70] Thereby placing an increased pressure to produce which in turn would further deteriorate the ecosystem and aggravate the scarcity of natural resources.

B. SOCIAL

Short-termism is known to aggravate inequalities in the society. This is primarily because share ownership is often accumulated by the richest households achieving higher share prices and larger dividend pay-outs.[71] Corporations are mainly focused on the shorter terms and this approach serves only a minor chunk of a country, i.e. the shareholders. As a result, the existing socio-economic disparities are only exacerbated.[72] This is applicable to the shareholding structures globally. It is intriguing to note that the disparity status when compared to that of the world, revealed that the global tendency for the shareholding of the top one percent and the

---

[68] United Nations Environment Program, *International Resource Panel, Global Resources Outlook 2019: Natural Resources for the Future We Want*, UN (2019) https://www.resourcepanel.org/reports/global-resources-outlook.

[69] Organisation for Economic Co-operation and Development, *Report on Global Material Resources Outlook to 2060*, OECD (2019) https://www.oecd.org/env/global-material-resources-outlook-to-2060-9789264307452-en.htm.

[70] *Id.*

[71] Robert Gebeloff, *Who Owns Stocks? Explaining the Rise in Inequality During the Pandemic*, NEW YORK TIMES (Jan. 26, 2021) https://www.nytimes.com/2021/01/26/upshot/stocks-pandemic-inequality.html.

[72] Thomas Clarke, *Why Shareholder Value Drives Income Inequality*, THE CONVERSATION (Jul. 26, 2018) https://theconversation.com/why-shareholder-value-drives-income-inequality-100324.

ten percent increased between the period of two decades, i.e. 1980-2000, and in following two decades witnessed a depletion. Whereas in the Indian context, the spike for the period of 1980-1990 was slow but picked up pace after the liberalisation of the economy and the trends for the last two decades suggest that the fraction placed on top had more income than the global average.[73] Further, the share of the bottom half has depicted a varied pattern. For India, the same has fallen only in the last four decades. On the contrary, the international average, while still lower than India, has experienced a hike during the said period.[74]This disparity and concentration of share ownership translates to the fact that short-termism is essentially the concept of serving a wealthy fraction, across the globe.

Executive compensation schemes that are greatly inclined towards stock-linked aspects also play a role in the increasing social inequalities. Due to the stock-based remuneration, there has been a staggering rise in the inclination of the executive compensation to the stock market.[75] In India, during the peak pandemic period, i.e. FY 2020-2021, the annual reports of companies indicate that several CEOs and board members experienced a hike in their salaries while their employees did not.[76] For instance, the CEO of Mindtree, Debashis Chatterjee's salary was increased to Rs. 11.3 crore and saw a growth of 131 percent while the average raise in the employees' salary was ten percent for the same financial year. On an

---

[73] Madan Sabnavis, *India's Unequal Growth Journey*, THE HINDU BUSINESS LINE(Dec. 14, 2021) https://www.thehindubusinessline.com/opinion/indias-unequal-growth-journey/article37954982.ece.

[74] *Id.*

[75] Lawrence Michel& Julia Wolfe, *CEO Compensation has Grown 940%Since 1978*, ECONOMIC POLICY INSTITUTE (Aug. 14, 2019)https://www.epi.org/publication/ceo-compensation-2018/#:~:text=CEO%20compensation%20continues%20to%20be,using%20the%20options%2Dgranted%20measure.

[76] Samiksha Goel, *Pandemic Conundrum: CEO Salaries Rise While Workers' Pay Remain Stagnant*, THE NEW INDIAN EXPRESS (Sept. 24, 2021) https://www.newindianexpress.com/business/2021/sep/24/pandemic-conundrum-ceo-salaries-rise-while-workers-pay-stays-stagnant-2363001.html.

average, the increase in the remuneration for management for FY 2020-2021 was noted to be around 55.22 percent whereas the median hike in the employee salary was 0.03 percent.[77]

The average ratio of CEO remuneration to that of an average employee for NSE500 companies in 2020 was 213:1 for promoter-CEOs and 152:1 for professional CEOs.[78] Our position is similar to that of the US, where the ratio was 299:1 for S & P 500 companies in 2020, up from 264:1 in 2019.[79] A juxtaposition of various countries for the year 2018 suggests that India lies second to the US in the said pay-ratio. Other countries such as China, UK and Canada have lower ratios.[80]

The short-term pursuit for immediate profits has produced immense pressure to disparage the wages of non-executive works, remodel employees as independent contractors so as to abstain from paying bonuses, pensions or other benefits and the introduction of outsourcing tasks to contracting companies, an industry which essentially competes to pay lower and lower wages.[81] Therefore, it is evident that short-termism is accompanied by a framework of benefiting its shareowners by jeopardising non-executive employee welfare and compensation schemes.

In addition to this, the human rights violations that take place in companies throughout their international supply and value chains is another grave cause damaging the interaction between corporations and society.[82] Parlous labour and human rights violations by the largest of

---

[77] *Id.*

[78] Sanjay Kallapu & Prasad Vemuri, *A Good Way Out of Our CEO Compensation Conundrum*, LIVE MINT (Oct. 11, 2021) https://www.livemint.com/opinion/online-views/a-good-way-out-of-our-ceo-compensation-conundrum-11633967646105.html.

[79] *Id.*

[80] *Id.*

[81] David Weil, *The Fissured Workplace: Why Work Became So Bad for So Many and What Can Be Done To Improve It*, 89(3) SOCIAL SCIENCE REVIEW 568 (2017).

[82] Elisa Giuliani & Chaira Macchi, *'Multinational Corporations' Economic and Human Rights Impacts on Developing Countries: A Review and Research Agenda*, 38(2) CAMBRIDGE JOURNAL OF ECONOMICS 479, 480 (2014).

companies, in developing countries such as India[83] is revealing of the ground realities of worker protection policies, and the corporate obsession with profit maximisation and executive compensation. The working conditions of the labourers working for apparel companies, or the production units of electronic devices[84], are almost devoid of human rights safeguards due to the enormous pressure of lower pricing from the companies to the suppliers in third world countries.[85]Therefore, the corporate culture of short-termism is closely intertwined with the pressure to deteriorate employee working conditions by incorporating hazardous contract clauses and poor wages.

Another notable factor curbing employee welfare is the desire to maximise short-term profits which diverts investments from long-term value creation through employee training.[86] Employee training is not just symbolic of a long-term strategy but also acts as a motorist of sustainability in itself. A training programme enables employees to develop and hone their skills which in turn can be regarded as a vital step in tackling sustainability challenges. In addition to that, improved skills

---

[83] Martje Theuws & Pauline Overeem, *International Companies Linked to Forced Labour in India*, SOMO(May 27, 2021) https://www.somo.nl/international-companies-linked-to-forced-labour-in-indian-spinning-mills/.

[84] Feza T. Azmi, *The Little Hands of Labour Behind your Smartphone*, THE WIRE (Jun. 16, 2021) https://thewire.in/rights/child-labour-unicef-mines-amnesty-international-ilo.

[85] Jaakko Salminen & Mikko Rajavouri, *Transnational Sustainability Laws and the Regulation of Global Value Chains: Comparison and a Framework for Analysis*, 26(5) MAASTRICHT JOURNAL OF EUROPEAN AND COMPARATIVE LAW 602, 626 (2019); Annie Kelly, *Worst Fashion Theft*, THE GUARDIAN (Dec. 16, 2021) https://www.theguardian.com/global-development/2021/dec/16/worst-fashion-wage-theft-workers-go-hungry-as-indian-suppliers-to-top-uk-brands-refuse-to-pay-minimum-wage.

[86] Jeremy Stein, *Agency, Information and Corporate Investment: Handbook of the Economics of Finance*, HARVARD UNIVERSITY (2003) https://scholar.harvard.edu/files/stein/files/agency-2003.pdf.

can also encourage investment, innovation in the market and increase competition which will ultimately benefit the society.[87]

C. ECONOMIC

The practice of shareholder primacy within the framework of corporate governance, coupled with pressure from investors insistent on short-term market value of shares , collectively pressurises the board to give primacy to the market value of the firm and chase short-term returns.[88] This comes at the cost of improved employee compensation and lucrative investments that will pay off only in the long run, such as the capital expenditure and R&D of the company.[89]

As an extension of short-termism, some directors began to function under the impression that they were required to lower the companies' tax liability, so much so that this resulted in tax avoidance, as in the case of Luxleaks and the Panama Papers scandals.[90]The object behind this was to externalise the risk by lowering the tax quotation. As per the findings of The Tax Justice Network, India annually loses approximately $10.11 billion due to international corporate tax abuse by virtue of Outward Foreign Direct Investments.[91]Such acts increase the tax burden on the

---

[87] International Labour Organisation, *Report on World Employment and Social Outlook 2018: Greening with Jobs*, ILO (May 14, 2018) https://www.ilo.org/global/publications/books/WCMS_628654/lang--en/index.htm.
[88] J.W. Mason, *Disgorge the Cash: The Disconnect Between Corporate Borrowing and Investment*, THE ROOSEVELT INSTITUTE (Feb. 25, 2015)https://rooseveltinstitute.org/publications/disgorge-the-cash/.
[89] *Id.*
[90] Jim Brunsden, *Lux Leaks: Luxembourg's Response to an International Tax Scandal*, FINANCIAL TIMES (Jun. 23, 2017) https://www.ft.com/content/de228b90-3632-11e7-99bd-13beb0903fa3; Paul Gregoire, *The Panama Papers: A Lesson in Tax Avoidance*, LEXOLOGY (Feb. 14, 2019) https://www.lexology.com/library/detail.aspx?g=d25bda85-f2d3-48cd-85e8-45c26e758c00.
[91] Lubna Kably, *India losing over Rs.70,000 Crore in Taxes to Other Countries*, THE TIMES OF INDIA (Nov. 20, 2020) https://timesofindia.indiatimes.com/business/india-business/tax-abuse-results-in-countries-losing-over-427bn-in-tax-each-year-indias-tax-loss-is-pegged-at-10-3bn-study/articleshow/79320131.cms.

citizenry and local companies. Simply put, this is because the tax on the earning of multinational companies is to be paid from the pockets of the company's shareholders, who are a part of the wealthy fraction of the society. If this tax burden on corporate returns declines, the overall tax burden resultantly shifts towards the labour class.

The practice of tax avoidance also adversely affects the income tax collected by the governments and hinders their ability to make welfare investments such as developing infrastructure, improving education as well as R&D.

From the perspective of microeconomics, it has been observed that the violation of planetary boundaries will cause certain risks for the corporate sector. These include the disruption of the supply chain, dearth of raw materials for production, rise in costs and introduction of more stringent regulatory provisions.[92] A foreseeable ramification of the aforesaid impacts negatively on the costs of production, market competition, profitability and employment.[93]

Studies suggest that companies that incorporate sustainability aspects function and deliver better.[94] Therefore, companies that continue short-term practices will not just aggravate unsustainability, but will also not make long term-oriented investments that are essential to keep them buoyant, feasible and sustainable in the times to come.[95] As per a report by the World Economic Forum on Global Risks,[96] the most acute risks

---

[92] University of Cambridge Institute for Sustainability Leadership, *Linking Planetary Boundaries to Business: The First White Paper in Kering's Series on Planetary Boundaries for Business*, KERING (Jan. 15, 2019) https://www.kering.com/en/news/linking-planetary-boundaries-to-business.

[93] *Id.*

[94] Gunnar Friede et al., *ESG and Financial Performance: Aggravated Evidence from more than 2E000 Empirical Studies*, 5(4) JOURNAL OF SUSTAINABLE FINANCE & INVESTMENT 210, 226-227 (2015).

[95] *Id.*

[96] World Economic Forum, *The Global Risks Report*, WEF (Jan. 15, 2019) https://www.weforum.org/reports/the-global-risks-report-2019.

involved in business – climate change and natural calamities are closely linked to unsustainable practices.[97] It is pertinent to recognise the magnitude of risk that such practices pose. This is because it can lead to the dissolution of the companies due to the lack or erroneous identification of these risks, which in turn impacts the company's capability to serve the shareholders and create value for them in the long run.[98]

V. RECOMMENDATIONS: TACKLING SHORT-TERMISM IN INDIA

The causes and the resulting issues that give rise to short-termism in India do not find any form of analysis by scholars. Such an investigation is essential to find the root of the issue of short-termism and thereafter form policies to address the said issue. Thus, in order to bridge this research gap, in this part, we seek to analyse the issues surrounding short-termism in India and the causes thereof, and simultaneously provide suitable recommendations.

A. DUTY OF THE DIRECTORS

It is contended that the directors' duties under the Act are ill-defined and lack sufficient precision in order to enable corporate long-termism. The board of directors of a company are responsible for the control and superintendence of the company's affairs.[99] As noted by the Supreme Court in *Sunil Bharti Mittal* v. *Central Bureau of Central Investigation*,[100] the board of directors is considered as the mind and brain behind a company.

---

97 *Id.*
98 *Id.*
99 Seema Jhingan, *Roles and Responsibilities of a Director under the Companies Act, 2013 – Pitfalls and Safeguards*, MONDAQ (Jul. 18, 2016) https://www.mondaq.com/india/directors-and-officers/510724/roles-and-responsibilities-of-a-director-under-companies-act-2013-pitfalls-and-safeguards.
100 AIR 2015 SC 923 (Ind.).

The core duties of such directors are embodied under §166 of the Act.[101]Arguably, one of the core duties of the directors amongst the aforementioned is the duty to promote the 'interest' of the company.[102] However, under the Indian jurisprudence, the said phrase finds no further interpretation amongst courts or scholars.[103] This results in the lack of proper understanding as to what the interest of the company precisely entails. On one hand it is argued that the promotion of the interest of the company could simply entail a negative duty to not promote the personal interests of the directors and favour the company's interest. On the other hand, as has frequently occurred,[104] the promotion of the company's interest can be equated to furthering the shareholders' interests and thereby boosting their primacy. Therefore, such an approach arguably hampers the long-term sustainable evolution of a company and instead drives the company's resources towards the goal of maximising the short-term value of the shareholders.

Hence, this absence of a clear demarcation of the interests of the company under the domestic framework provides room for a liberal interpretation by the companies and often results in it being equated to the shareholder's interests.

Further, §166 does not mention the duty of the director to alleviate the long-term sustainability risks with respect to the social, economic and environmental impact. Such risks can have both an internal effect to the company in relation to its management, as well as external effect with

---

[101] The Companies Act, No. 18 of 2013, §166(2) (Ind.).

[102] Ministry of Corporate Affairs, *Related Party Transactions*, MCA, https://www.mca.gov.in/Ministry/reportonexpertcommitte/chapter5.html.

[103] *See generally* A. RAMAIYA, GUIDE TO THE COMPANIES ACT, CHAPTER XI, APPOINTMENT AND QUALIFICATIONS OF DIRECTOR3 (Vol. 2, 19th ed.2020).

[104] Mihir Naniwadekar & Umakanth Varottil, *Directors' Duties and Stakeholder Interests: Comparing India and the United Kingdom*, UNIVERSITY OF OXFORD, FACULTY OF LAW (Aug. 28, 2016) https://www.law.ox.ac.uk/business-law-blog/blog/2016/08/directors%E2%80%99-duties-and-stakeholder-interests-comparing-india-and.

respect to the company's furtherance of the overarching sustainable goals. Though, "protection of the environment" is an explicit duty of the directors,[105] the same has limited operation and cannot be equated with the broader goals of sustainable growth of the company.

Hence, in the absence of an explicit duty to mitigate the sustainability risks in the long-term, coupled with the excessive focus on shareholder primacy and the short-term market pressure as identified in Part III, the directors of the companies are motivated and driven to maximise the shareholder value and tackle short-term imperils, instead of undertaking a long-term sustainable approach. Such a narrow delineation of the duties of the directors arguably results in an adverse effect on the employees and the general public, such as the communities where the companies operate in and have their supply chain. Lastly, a narrow delineation of the interest of the company also undermines its very ability to contribute to sustainable corporate governance.

In light of the aforesaid issues faced with respect to the delineation of the duty of directors, we provide certain recommendations that can assist in limiting corporate short-termism. In this regard, we recommend that §166 of the Act be amended to specifically include the duty of the directors to achieve a proper balance between the interests of the shareholders and the accompanying interests of the employees, environment, and the society at large. Further, the duty to achieve such a balance should explicitly be clarified as an element of the 'company's interest' in the long-term, which can, in terms of duration, be defined to be somewhere between five to ten years. In our opinion, such a duration would motivate the directors to assess the future sustainable risks that the company may face in the subsequent years, instead of diverting all resources towards short-term output.

[105] The Companies Act, 2013, No. 18 of 2013, §166(2) (Ind.).

Such a legislative measure would fill the void in the express delineation of the director's liability that is connected with the fulfilment of long-term goals. It is acknowledged that such policy change may have effects on the company for a short period of time with respect to the restructuring of the internal policies and rise in costs. However, in the longer run, it is argued that the focus on long-termism would enable the company to achieve resilience against detrimental effects of climate change and health crises such as COVID-19, as well as boost corporate governance, which itself results in economic efficacy. This is in addition to the large-scale social and environmental impact that such a policy change enables. This is because it will motivate the directors to directly focus on the social risks and impacts of the functioning of the company. For instance, programmes could be set-up to increase workplace health and safety and augment the working environment.

Furthermore, it is argued that a possible solution to the issue of narrow directors' duties, through intensive awareness campaigns, would not be an ideal method. As per the above discussion and the analysis made in Part III, it is noticeable that the primary focus on the shareholders is deeply embedded in the Indian culture of governance. Hence, arguably, a mere awareness campaign is unlikely to have a large-scale impact that is required to deal with short-termism. There shall be various loose variables, such as the motivation of the directors and the effective nature of the awareness drives that will determine any positive result. Thus, a legislative method, in our opinion, is a strong, balanced, and a logical way forward to broaden the duties of the directors and drive companies towards a long-term sustainable growth.

B. INSTITUTIONAL INVESTORS

Another cause of short-termism in India is, we argue, to be related to the parallel rise in institutional investors. Institutional investors are defined as organisations which, in the name of other people, invest capital

in other organisations.[106] These include organisations that provide mutual funds, insurance, and pensions.[107] Institutional investors typically trade in large quantities and possess large amounts of shares and resultantly influence the stock market.[108] India has witnessed a substantial rise in institutional investments over the last decade.[109] In the first three quarters of 2021 alone, the institutional investments were over fifty billion dollars, which surpassed the total amount invested through such institutions in 2020.[110]

This growing rise in the institutional investments can be correlated to the simultaneous rise in short-termism. The institutional investors, together with the activist investors who possess hedge-funds tend to focus primarily on the short-term shareholder value.[111] This is because these activists only hold over one to two percent of the stocks and therefore have a natural short-term viewpoint.[112] Hence, such activists

---

106 James Chen et al., *Institutional Investor*, INVESTOPEDIA (Nov. 22, 2021) https://www.investopedia.com/terms/i/institutionalinvestor.asp#:~:text=An%20institutional%20investor%20is%20a,and%20insurance%20companies%20are%20examples.&text=The%20group%20is%20also%20viewed,subject%20to%20less%20restrictive%20regulations.

107 Corporate Financial Institution, *Institutional Investor*,CFI,https://corporatefinanceinstitute.com/resources/knowledge/trading-investing/institutional-investor/.

108 Barclay Palmer et al., *Institutional vs. Retail Investors: What's the Difference?*, INVESTOPEDIA (Dec. 6, 2021) https://www.investopedia.com/ask/answers/06/institutionalinvestor.asp.

109 Himani Goel & Vatsal Khullar, *A Year that was – Driving Institutional Investment in India*, INVEST INDIA (Jan. 12, 2022) https://www.investindia.gov.in/team-india-blogs/year-was-driving-institutional-investment-india#:~:text=As%20a%20result%2C%20the%20first,in%20the%20India%20growth%20story; For a review on institutional investors in India, *see also* Amiya Sahu et al., *Institutional Investments in India: A Review of Literature*, SSRN ELECTRONIC JOURNAL 1,1-10 (2013).

110 *Id.*

111 Robert C. Pozen, *Institutional Investors and Corporate Short-Termism*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE(Aug. 24, 2015) https://corpgov.law.harvard.edu/2015/08/24/institutional-investors-and-corporate-short-termism/.

112 *Id.*

attempt to win support from the institutional investors, which usually they are successful in, and channel the company towards a short-term approach towards the stock prices and the value of the shareholders.[113] Naturally, the institutional investors also coerce the board in maximising the short-term value of the shares and quarterly returns, instead of a long-term sustainable growth.

Resultantly, the same can affect the shareholders possessing a long-term interest, the employees of the company as well as the society at large. The pressure from institutional investors to administer the company in a way to yield short-term profits comes at the expense of the long-term sustainable functioning of the company.

In light of this, it is proposed that mechanism be introduced at the national level so as to incentivise the shareholders to make long-term oriented investments. For instance, the mandate under Clause 41 of the LODR Regulations to make quarterly disclosures can be done away with. A shortcoming of this system could be its negative impact on the functioning of capital markets which would affect the monetary capacity of listed companies by lowering its liquidity and perhaps even diverting this capital to foreign markets.

That being said, alternatively, the implementation of such measures could also encourage longer shareholding spans, which in turn would nurture long-term investors and assist companies going beyond the short-term horizon, focus on long-term value creation and possibly improve the social aspects of employee, supply chain and community operations. The scope for improved long-term focus can also help the board make environmentally friendly strategies.

---

[113] Robert C. Pozen, *The Role of Institutional Investors in Curbing Corporate Short-Termism*, BROOKINGS (Aug. 11, 2015) https://www.brookings.edu/articles/the-role-of-institutional-investors-in-curbing-corporate-short-termism/; Hyun-Dong Kim et al., *Short-Term Institutional Investors and Agency Costs of Debt*, 95 EUROPEAN FINANCIAL MANAGEMENT ASSOCIATION 1, 25 (2019).

Overall, the proposed measures would allow a level play field and aid long term-value creation, bring about innovation, productivity and growth and therefore have positive macroeconomic impacts. The proposed framework provides companies with a more stable group of investors which would relieve the board from the pressure to deliver short-term returns, allowing them to pay attention to sustainable strategies and investments that will reap results in the long-term. Thus, increasing the companies' profitability, productivity, sustainability and innovation.

C. THE BOARD OF DIRECTORS

With respect to the operation of the board of directors, we have two concerns to present. *First*, is regarding the method of remuneration for the board, and *second*, is related to the composition of the board itself. The same are discussed in the two parts below.

1. Remuneration to the Board

It is postulated that the present framework of the payment to the board of directors is unsuitable and a prime driver for short-termism in India. The remuneration to the board of directors is provided as per §197 of the Act and is based on the net profit registered by the company in the concerned financial year.[114] Herein, the total managerial remuneration can be to over eleven percent of the net profits,[115] with §198 laying down the methodology for the calculation of such profits.[116]

In this regard, such profit-based remuneration for the board instead can result in the pressurisation for maximising short-term profits and

[114] The Companies Act, 2013, No. 18 of 2013, §197 (Ind.).
[115] *Id.* §197(1).
[116] *Id.* §198.

shareholder value.[117] The same incentivises the board to concentrate on the management of the company's resources in such a manner so as to augment the share price at the cost of a long-term sustainable policy.[118]

Further, it is noticeable that the inclusion of considerations such as fulfilment of ESG standard and other non-financial sustainable measures are absent as factors for remunerations provided to the board of directors. The promotion of ESG practices has specifically taken a boost in India over the past decade.[119] In 2021, the assets under management (which are the total market value of investments that an entity manages on behalf of clients)[120] of ESG were calculated at over 123 billion rupees.[121] The same was over five times the assets under management from two years before.[122] The Act along with its accompanying rules and regulations embody various mandates regarding the disclosure of ESG practices for the companies.[123] The implementation of ESG practices and the disclosure of the same is highly attractive for the investors since it

---

117 Jonathan Pogach, *Short-Termism of Executive Compensation*, FEDERAL DEPOSIT INSURANCE CORPORATION 1, 2 (2015); Gregg D. Polsky & Andrrew C. W. Lund, *Can Executive Compensation Reform Cure Short-Termism*, 58 Governance Studies 1, 1-2 (2013).

118 Ira Kay et al., *Executive Pay, Share Buybacks, and Managerial Short-Termism*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE (Jan. 26, 2016) https://corpgov.law.harvard.edu/2016/01/26/executive-pay-share-buybacks-and-managerial-short-termism/.

119 Shailesh Tyagi, *How ESG Reporting Landscape is Evolving in India*, EY (Aug. 26, 2021) https://www.ey.com/en_in/climate-change-sustainability-services/how-esg-reporting-landscape-is-evolving-in-india.

120 James Chen, *Assets Under Management*, INVESTOPEDIA (Oct. 6, 2020) https://www.investopedia.com/terms/a/aum.asp.

121 Indus Law, *ESG Reporting and its Framework in India*, LEGAL 500 (Feb. 2, 2022) https://www.legal500.com/developments/thought-leadership/esg-reporting-and-its-framework-in-india/.

122 *Id.*

123 *See generally* The Companies Act, 2013, No. 18 of 2013, §134(m) (Ind.); The Companies (Accounts) Rules, 2014, Gazette of India, pt. II sec. 3(i), Rule 8(3)(A) (Mar. 31, 2014); The SEBI (Listing Obligation and Disclosure Requirements) Regulation, 2015, Gazette of India, pt. II sec. 4, Reg. 34 (Sept. 2, 2015).

showcases the extent of the company's consciousness towards sustainability and its future financial stability.[124]

Hence, it implies that even though the ESG practices are carefully scrutinised and reported by various companies as per the relevant legislations, the same are not associated with the remuneration received by the board. Thus, there is a detachment between the sustainable performance of the company and the structures for remuneration of the board.

Therefore, in view of the impending concern regarding the mode of remuneration for the board, it is argued that the appropriate amendments are required in order to encourage long-term activities. Accordingly, we recommend that §197 of the Act should be amended to include non-financial factors such as the compliance with ESG standards and sustainable goals of the company should be included in the pay structure of the board.

Such an amendment is argued to positively impact the sustainable growth of the company by motivating the directors to implement such practices in lieu of financial incentives. Naturally, the same shall attract investors and also encourage directors to promote innovation and a sustainable framework for business, ultimately resulting in the economic growth of the company and the aversion of future sustainability-related risks. Further, in the social context, the companies shall be encouraged to provide broad ranging ESG targets such as employee and customer satisfaction, and the business impact on the local communities. Environmentally, the amendment would ensure further considerations to factors of climate change, preservation of eco-system, as well as improving the efficiency of resources.

---

[124] R. Boffo & R. Patalano, *ESG Investing: Practices, Progress and Challenges*, OECD (2020) https://www.oecd.org/finance/ESG-Investing-Practices-Progress-Challenges.pdf.

Moreover, a more lenient approach of conducting awareness campaign is unlikely to influence the short-term targets of the board and is unlikely, in our opinion, to result in any material change in the policy. Therefore, it is recommended that §197 of the Act should be amended as argued above in order to create financial incentives for the board to focus on long-term development of the company.

2. Composition of the Board

It is argued that the regulations behind the composition of the board of directors of the Indian companies are ill-suited for promoting long-termism. Scholars have highlighted how the experience, backgrounds, and the diverse background of the board are crucial factors for reducing corporate short-termism practices.[125] Hence, a diversified board possessing wide range of experience and skills is essential in order to defy the business-as-usual approach and question the short-term intent of the management.[126] This ultimately improves the economic efficiency of the company concerned.

In India, data showcases that the diversity of the companies' boards face a grim reality. In an important study that was supported by the National Stock Exchange of India, a scholar conducts a review of the board composition of over 500 top companies in India.[127] The report highlights that over a majority of the directors in the boards of these companies have an educational qualification in banking and finance, which is followed by management.[128] Other areas of prevalent expertise include law, administration, marketing, information technology,

---

[125] Angelica Gonzalez & Paul Andre, *Board Effectiveness and Short-Termism*, 41 JOURNAL OF BUSINESS FINANCE & ACCOUNTING 1, 1-2 (2012).
[126] *Id.*
[127] J. N. Gupta, *Report on Board Composition of Top 500 Companies*, STAKEHOLDERS EMPOWERMENT SERVICES(2018) https://www.sesgovernance.com/pdf/1523435610_Part-A--Board-Composition-Report.pdf.
[128] *Id.* at 41.

accountancy, amongst others.[129] Thus, it is evident that there is an absence of members in the board with experience in ESG and sustainability, with the increasing domination of purely business-minded directors.

Further, the age and gender-based diversity amongst the board members are also opined to be detrimental for corporate long-termism. Between the select 500 companies, the total number of women directors have increased from 11.5 percent to a mere 13.1 percent from 2014 to 2017.[130] Amongst the public sector undertakings, the number of women directors stand at 12.8 percent, while the same is 13.8 percent amongst the multi-national companies.[131] Further, this proportion is severely low for the executive director posts with a mere representation of 7.3 percent.[132] Hence, it can be observed that the board of the Indian companies are a highly male dominated arena with limited involvement of females. Moreover, with respect to age, the average age of a male director was calculated to be 57.8 years, while the same was 52.9 years for female directors.[133] Thus, this highlights a rigid domination of older generations in the post of directorship.

Coupled with this data which highlights the lack of diversity in the company boards in India, is the problem regarding the absence of any standardised regulations for the same. The only regulation dealing with the composition of the board for listed companies is Regulation 17 of the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirement) Regulation, 2015 ("**LODR Regulations**").[134] The aforesaid provision, with respect to the diversity factors highlighted above, merely states the requirement of a minimum of one woman

---

[129] *Id.*
[130] *Id.* at 39.
[131] *Id.*
[132] *Id.* at 40.
[133] *Id.* at 43.
[134] The SEBI (Listing Obligation and Disclosure Requirements) Regulation, 2015, Gazette of India, pt. II sec. 4, Reg. 17 (Sept. 2, 2015).

director in the boards of the listed companies. The remaining segment of the regulation only deals with the composition of non-executive and independent directors – which is a question of roles and not related to diversity.

Hence, the apparent lack of diversity – the initiative for which is lacking from both the legislature and the companies – casts doubt regarding the ability of such board of directors to undertake a measured long-term approach and the mindset to fully appreciate and understand the expectations of the various stakeholders of the company. Thus, this lack of diversity, as is evident in the Indian corporate environment further contributes to the growing menace of short-termism.

In lieu of the aforesaid concerns regarding the composition of the board, it is recommended that suitable policy measures be implemented in order to achieve a more diverse board composition in the companies. Resultantly, it is suggested that Regulation 17 of the LODR Regulations be amended to include sustainability considerations during the appointment of the directors. Herein, an increase in the minimum requirement of female directors to possibly fifty percent, as well as mandatory inclusion of at least twenty-five to thirty percent members with expertise in sustainability, environment, and related issues of ESG, would be the required adequate changes. Further, to formulate a young as well as experienced board for the companies, it is argued that a suitable requirement for the inclusion of younger directors should also be included under Regulation 17 of the LODR Regulations.

It is recognised that such a proposal for the changes in the board composition may impact the extra burden on the company to fulfil the requirements of the directors and thereby make it difficult for them to enlist. However, it is argued that the fulfilment of the same shall be in the long-term interest of the company and would attract potential investors, further build the reputation of the company, as well as ensure that reasoned and knowledgeable sustainability determinations are made by the

board. Therefore, it will naturally possess a positive economic impact on the company. Additionally, the same would also have a positive social and environmental impact. In this regard, the institutionalisation of the notion of sustainability shall take place within the company itself, and as one may expect, issues such as climate change would find more importance and frequent mention within the board and its decisions for the company.

One can anticipate that without a regulatory amendment that mandates such obligations, a company would be unwilling to create an extra qualification for its board of directors. Hence, lenient approaches such as awareness campaigns or more advisories are unlikely to impact the composition of the companies' boards. Thus, it is recommended that in order to formulate a diverse board which focuses on the long-term sustainable functioning of the company, an amendment to Regulation 17 of the LODR Regulations as delineated above is required.

D. SUSTAINABLE CORPORATE GOVERNANCE

Under the Indian legal framework, it is postulated that the embedded aspects of sustainable long-term governance of the company and important measures required to avert economic and social risks are absent. Though, as highlighted above, there exist certain requirements for disclosure regarding ESG performance of the company, the same cannot be equated to a minimum standard of sustainable growth. Even the most recent introduction of the Business Responsibility and Sustainability Report, through an amendment to Regulation 34(2)(f) of the LODR Regulations, which aligns with the principles of National Guidelines for Responsible Business Conduct does not delineate a common minimum standard.[135] The said Guidelines provide further ESG mandates such as the disclosure of climate and social related issues, the disclosure of

[135] Security and Exchange Board of India, *Business Responsibility and Sustainability Reporting by Listed Entities*, SEBI (May 10, 2021) https://www.sebi.gov.in/legal/circulars/may-2021/business-responsibility-and-sustainability-reporting-by-listed-entities_50096.html.

policies which the company adopts to comply with ESG requirements, and the structuring of the disclosures into a more coherent manner.[136]

Therefore, apart from the mandatory requirements for disclosures, the actual implementation of the ESG goals and their compliance with the global goals of sustainable development is determined by the voluntary compliance and the disposition of the companies. The lack of such an approach towards sustainable governance directly affects the board itself, the shareholders of the company, as well as the society at largely, due to the likely absence of a long-term strategy and risk-mitigation policies.

In order to tackle the lack of incentives by companies to adopt sustainability in their business strategies, it is suggested that meaningful alterations be made to the regulatory framework of the country. While India was the first country to make Corporate Social Responsibility ('CSR') mandatory,[137] at present, the legal provisions do not mandate the directors of large-scale companies to incorporate sustainable practices into their business strategies, nor do they require demarcation of goals when adopting sustainability in the framework.

Currently, the existence of self-regulatory system of a recommendatory nature is for encouraging corporations to undertake sustainable practices, particularly in the environmental and social arena. However, the emerging trend mandating ESG norms are worth underlining but it is not sufficient.[138] A more level playing field can be expected to ensue as a result of the introduction of the proposed

---

[136] Tax Guru, *Business Responsibility and Sustainability Reporting by Listed Entities*, TAX GURU (May 10, 2021) https://taxguru.in/sebi/business-responsibility-sustainability-reporting-listed-entities.html.

[137] Deepa Krishnan, *Making Indian Businesses Sustainable*, STRATEGY BUSINESS (Sept. 11, 2019) https://www.strategy-business.com/article/Making-Indian-businesses-sustainable.

[138] Eshvar Girish, *ESG in Indian Companies: Thinking Through the Sustainable Lens?*, THE NATIONAL LAW REVIEW (Sept. 9, 2021) https://www.natlawreview.com/article/esg-indian-companies-thinking-through-sustainability-lens.

legislation, this is because these regulations will be applicable across the board, including large-scale companies.

The induction of concrete, fixed term, scientific, quantifiable and specified goals can also help companies set sustainability goals in consonance with their other broader targets, including the Sustainable Development Goals. Under the proposed framework, the flexibility to tweak requirements for different companies to suit the nature of their business and corporate culture would however cease in furtherance of uniformity. Consequently, it will raise the overall compliance cost to be incurred by the companies in the short-term. However, in the long-term, it would prepare the company to tackle risks associated with sustainability and shortage which might have endangered its smooth operation and even aid in keeping it afloat in times of crisis.

Additionally, the increased costs would have a positive impact on market competitiveness in the long-term as the company would be able to ward off expenditures due to early risk detection, differentiation from other companies which can improve trade flow and increased investment. Owing to the time-bound, specific and quantifiable nature of these sustainability goals, it would also allow improved assessment of the impact of the goals, particularly in sphere of working conditions – health and safety of the workers, mitigation of poverty and the wage gap along the supply chain. The disclosure of such data would aid trade unions, non-governmental organisations as well as government authorities to monitor companies resulting in better accountability and transparency.

From an environmental perspective, the proposed framework can be expected to bring about an efficacious effect as the sustainable practices will help the ecosystem, and improve resource efficiency and the economy

at large. This includes India's commitment to contain its greenhouse emissions and use of coal in line with the Paris Agreement.[139]

VI. CONCLUSION

"It is truly said that a corporation has no conscience. But, a corporation of conscientious men is a corporation with a conscience" said Henry D. Thoreau. Today, India is the six-largest economy in the world. We have grown in leaps and bound across sectors – textiles, information technology, pharmaceuticals, steel and several others. Resultantly, good corporate governance is more relevant than ever before. It should be weaponised towards social responsibility, safeguarding of the ecosystem, corporate social upliftment and value creation for all its stakeholders.

In keeping with that, short-term policies followed by companies are extremely detrimental to not only the companies but also the environment and society at large. They exacerbate environmental degradation aggravate inequality in the society while also endangering the companies' performance in the long haul. Therefore, it is argued that necessary reforms be made so as to aid directors in identifying and mitigating the sustainability risk faced by them and its impacts which affect the company's operation and stakeholders. A fine balance between the interests of the shareholders and the long-term interests of the company, its workers, supply chain, customers, local as well as universal ecosystem is the need of the hour.

In this paper, we have explored the relationship between corporate governance and short-termism. Further, we identified the rise of short-termism in the corporate sector of India at a rapid rate. Notably, the

---

[139] United Nations Climate Change, *The Paris Agreement*, UN, https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement; Urmi Goswami, I*ndia Set to Update 2030 Climate Change Targets under Paris Agreement*, ECONOMIC TIMES (Oct. 18, 2021)https://economictimes.indiatimes.com/news/india/india-set-to-update-its-2030-climate-targets-under-paris-agreement/articleshow/87098192.cmsaccessed.

Sensex 30 companies identified for the purpose of the study have multiplied their DPR over the last five financial years. This is the evidence of the presence as well as the rise of short-termism in India. Further, short-termism possesses an adverse impact on the economic, social and the environmental sphere.

The paper also highlights the root causes of short-termism in India and simultaneously provides recommendations to deal with these issues. Herein, recommendations are made with respect to the duty of the directors, the composition and the remuneration of the board of company, the institutional investments in the corporate sector, as well as the ESG obligations of the companies. It is however emphasised that such recommendations do not intend to push through a straightjacket formula and take away their independence in management. Instead, such policy changes are necessary to address the crucial policy of sustainable corporate governance that take primacy in the modern world. Further, as highlighted in Part V, less lenient and stringent measures are unlikely to bring about any significant changes to the current corporate practices.

Accordingly, it is argued that the recommendations help in achieving an ideal balance between the long-term and short-term interests of the companies in India. We hope that such an initiation on the issue of short-termism would assist in sparkling a debate in the corporate sector of the country.

VII. ANNEXURE – I

Company Name	**DPR for FY 2016-2017**	**DPR for FY 2017-2018**	**DPR for FY 2018-2019**	**DPR for FY 2019-2020**	**DPR for FY 2020-2021**
Asian Paints	0.50	0.40	0.47	0.42	0.54
Axis Bank	0.30	0	0.50	0.50	0.51
Bajaj	0.10	0.09	0.09	0.12	0.13

Finance					
Bajaj Finserv	0.008	0.007	0.007	0.013	0.060
Britannia	0.15	0.15	0.31	0.60	2.2
Dr. Reddy Lab	0.26	0.36	0.17	0.21	0.21
HCL Technologies	0.40	0.20	0.10	0.25	0.25
HDFC	0.26	0.28	0.22	0.17	0.23
HDFC Bank	0.09	0.09	0.09	0.05	0.11
HUL	0.85	0.83	0.79	0.80	1.19
ICICI Bank	0.14	0.12	0.15	0.01	0.08
IndusInd Bank	0.12	0.12	0.13	0.01	0.14
Infosys	0.40	0.59	0.60	0.44	0.60
ITC	0.55	0.54	0.55	0.80	0.99
Kotak Mahindra Bank	0.02	0.02	0.02	0	0.02
Larsen & Turbo	0.28	0.26	0.24	0.23	0.40
Mahindra & Mahindra	0.22	0.11	0.20	- 0.20	4.21
Maruti Suzuki	0.30	0.31	0.32	0.32	0.32
Nestle	0.61	0.68	0.69	1.67	0.93
NTPC	0.39	0.42	0.45	0.27	0.42
Polycab India	0.06	0.04	0.08	0.13	0.16
Ployplex Corporation	0.06	0.45	0.27	0.11	0.60
Reliance Ind.	0.10	0.10	0.97	0.10	0.90

Sun Pharma	0.10	0.18	0.20	0.22	0.79
Tata Steel	- 0.23	0.06	0.17	1.22	0.40
TCS	0.35	0.37	0.35	0.84	0.44
Tech Mahindra	0.27	0.32	0.28	0.34	0.90
Titan	0.33	0.30	0.32	0.23	0.36
Ultratech Cement	0.10	0.13	0.13	0.06	0.20
Wipro	0.05	0.05	0.06	0.05	0.05
Total Average DPR	0.237	0.256	0.301	0.339	0.611
Total Average Dividend Payout %	23.7%	25.6%	30.1%	33.9%	61.1%

CIRCLE AMONG SQUARE: COMPARATIVELY ANALYSING THE ROLE AND NEED FOR INDEPENDENT DIRECTOR IN INDIA WITH SINGAPORE

Sriranjani R[*]

ABSTRACT

Following the Tata-Mistry Case[1] *that led to questioning the efficiency of independent directors in India, recent data on Indian corporate governance*[2] *reflects the flawed system that regulates independent directors. From random resignations without reasons*[3] *rooting back to the abstract qualification requirement in the Companies Act*[4]*, the status quo creates the need to critically analyse the regulations governing independent directors. This analysis aims to find out whether the role of Independent Directors is necessary for the betterment of Indian corporate governance and how, if necessary, it can be improved. In order to achieve the purpose of their creation, independent directors must fit into the corporate governance model prevalent in India. The existing laws governing independent directors focus more on the induction part rather than their accountability, which adds to their imperfect role in corporate governance. By comparing the Indian corporate governance model with another well-developed State Model such as Singapore, gaps and flaws in the Indian Model can be remodelled and improved. Ensuring accountability even after being inducted into companies would ensure efficient corporate governance and*

---

[*] The author is a fourth year student at Tamil Nadu National Law University, Tiruchirappalli.

[1] Tata Consultancy Services Limited v. Cyrus Investments Pvt. Ltd, (2021) SCC OnLine SC 272 (Ind.).

[2] Rica Bhattcharyya, *Resignations by independent directors double in 2019 as risks grow*, THE ECON. TIMES, (Dec. 26, 2019) https://economictimes.indiatimes.com/news/company/corporate-trends/resignations-by-independent-directors-double-in-2019-as-risks-grow/articleshow/72972968.cms?from=mdr.

[3] Jayshree P. Upadhyay, *Why independent directors are rushing for the exit door mint*, LIVE MINT (Dec. 19, 2018), https://www.livemint.com/Companies/bntAau6XcAhPfTZ5yCVx7O/Why-independent-directors-arerushingfortheexit-door.html.

[4] Companies Act, No. 18 of 2013, §. 149(6)(a) (Ind.).

the same can be done through a separate legal body such as a commission to ensure consistently efficient corporate governance in India. In this regard, the author will put forward certain suggestions as to how transparency can be brought into this system without compromising the autonomy of Indian Companies.

Keywords: Independent directors, Singapore, governance Models, Outsider and insider models.

TABLE OF CONTENTS

I. INTRODUCTION..99

II. PROBING THE REALITY OF INDEPENDENT DIRECTORS IN INDIA..102

III. ANALYSING THE PRAGMATIC PARADIGM: SINGAPOREAN MODEL OF INDEPENDENT DIRECTORS 107

IV. REVAMPING THE INDIAN LEGAL REGIME OF INDEPENDENT DIRECTORS...109

V. CONCLUSION 115

I. INTRODUCTION

The Satyam Scandal of 2009[5] was one of the "biggest accounting frauds" in India. It is one of those corporate frauds where the financial status of the company was falsely presented in the market, which *mislead* investors. This misrepresentation, which was primarily led by the promoters of the company, was well-concealed from the independent directors. This essentially created the need for independent directors in

[5] HT Correspondent, *Satyam scam: All you need to know about India's biggest accounting fraud*, HINDUSTAN TIMES (Apr. 09, 2015), https://www.hindustantimes.com/business/satyam-scam-all-you-need-to-know-about-india-s-biggest-accounting-fraud/story-YTfHTZy9K6NvsW8PxIEEYL.html.

India, with many reports making suggestions for the mandatory incorporation of independent directors, especially in publicly listed companies, to ensure effective corporate governance and balanced interests of all stakeholders. It has been almost a decade since independent directors were introduced in India through the Companies Act, 2013,[6] but the role of independent directors in India is still confounding, with them either being accused of breach of confidentiality[7] or running away from their responsibilities without citing proper reasons.[8] With the number of independent directors who resign without reason being almost triple the number of independent directors who retire after their tenure,[9] the whole system of governance of independent directors seems inefficient.

Independent directors have the most complex governing structure in Indian Corporate law, as they are not only governed by the Companies Act, 2013[10]but also by the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, which have been amended recently[11].

Appointed with the objective of acting as *watchdogs* of Corporate Governance in a Company, independent directors often find themselves caught between *Morality* and *Majority* (*morality* of improving corporate standards and standing against corrupt practices; the *majority* of

[6] *Supra* at 4, §. 149(4) and 149(6).
[7] Sucheta Dalal, *Tata-Mistry War: Case for a Rethink on Role of Independent Directors,* MONEYLIFE (Jan. 03, 2017), https://www.moneylife.in/article/tata-mistry-war-case-for-a-rethink-on-role-of-independent-directors/49322.html.
[8] *Supra* at 2.
[9] *Supra* at 3.
[10] *Supra* at 4, §. 149 & 150.
[11] Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2022, Gazette of India, pt. III sec. 4.

shareholders and promotors, who play a crucial role in deciding the continued employment of an independent director)[12].

With academicians and experts stating there is no "real" independence vested upon independent directors and that they always get stuck in big corporate feuds, the reason for their establishment in the Indian Corporate setup, especially in Public Listed Companies, seems to be in need of re-examination. *Does India need independent directors? What role do they play and whether they are really independent in the exercise of their "powers"* are some of the questions that are to be addressed.

Similar to almost all of the other statutes in India, the Companies Act, 2013 also derives its basis from the UK Legislation[13]. It is highly important to understand that despite the fact that Indian Jurisprudence is heavily influenced by the common law system, the model of corporate governance that is *in practice* in both these countries is not comparable.[14] But there are other Asian Countries that have adopted the UK and US models of independent directors such as Singapore. This research paper aims to critically analyse the legal position of independent directors in India by scrutinizing the existing laws governing independent directors and finding the flaws in the present regime. Additionally, this paper also aims to compare this model with the Singaporean counterpart, in order to understand the real need and role of independent directors in India and whether this present system of governance requires to be amended for its betterment. This comparison will essentially help in improving the present system into a more effective legal regime that would help the independent directors achieve their real objective.

---

[12] Devika Sharma, *Independent Directors: Role, Responsibilities, Effectiveness* SCC BLOG (Jul. 12, 2019), https://www.scconline.com/blog/post/2019/07/12/independent-directors-role-responsibilities-effectiveness/#_ftnref23.

[13] The Companies Act 2006, 54 ER II c. 46, (Eng.).

[14] Umakanth Varottil, *Evolution and Effectiveness of Independent Directors in Indian Corporate Governance*, 6 HASTINGS BUS. L. J. 281, (2010).

II. PROBING THE REALITY OF INDEPENDENT DIRECTORS IN INDIA

A. TRACING THE EMERGENCE AND DETERMINING THEIR STATUS QUO

The biggest company scandal of India ever, that is the Satyam Scam in 2009, threw light upon the harsh reality of how companies were hanging puppets at the whims and fancies of the Promoters.[15] There were many changes that were proposed to the then-existent Companies Act of 1956, and one of the most important amendments was the introduction of independent directors in India. It was the Kumar Mangalam Birla Committee that suggested incorporating independent directors in India,[16] which was followed while framing clause 49 of the Securities Exchange Board of India (SEBI) Guidelines.[17] Till 2013, there were various other reports such as the Naresh Chandra Committee,[18] Narayan Murthy Committee,[19] and lastly, the JJ Irani Committee,[20] all of which proposed contradicting provisions for independent directors which were finally clarified by the Companies Act, 2013.[21]

Section 149(6) of the Companies Act, 2013 provides a detailed description of how an independent director should be selected in a

---

15 *Supra* at 5.
16 SEBI, Report of Kumar Mangalam Birla Committee on Corporate Governance (2000), https://www.sebi.gov.in/sebi_data/commondocs/corpgov1_p.pdf.
17 SEBI, Clause 49, Listing Agreement, (2022).
18 MCA, REPORT OF THE CII TASK FORCE ON CORPORATE GOVERNANCE (2009), https://www.mca.gov.in/Ministry/latestnews/Draft_Report_NareshChandra_CII.pdf.
19 SEBI, REPORT OF SHRI N R NARAYANA MURTHY ON CORPORATE GOVERNANCE (2003), https://www.sebi.gov.in/reports/reports/mar-2003/the-report-of-shri-n-r-narayana-murthy-committee-on-corporate-governance-for-public-comments-_12986.html.
20 MCA, REPORT ON COMPANY LAW (2005), http://www.primedirectors.com/pdf/JJ%20Irani%20Report-MCA.pdf.
21 *Supra* at 4, §. 149(6).

company and also provides a code for independent directors.[22] The SEBI Guidelines and the LODR Regulations (originally 2015,[23] latest amendment of 2022)[24] also govern the independent directors in addition to the Companies Act, 2013.

On the face of it, the Companies Act, 2013 'seemingly' proposes an effective mechanism for curbing corporate malpractices and ensuring a better corporate standard in India, but in practical sense, the promoters seem to have the *upper hand*.[25]

The *Tata-Mistry fiasco*[26] became the proof of the same. Cyrus Investments raised a claim against the Tata group in the NCLT through the provisions of the Companies Act, 2013,[27] stating that the latter's actions have been "*detrimental to minority stakeholders*".[28] Nusli Wadia was also sacked as an independent director of Tata Steels by the promoters as the latter felt that there were *differential interests.*[29] The Tata-Mistry Saga alone emphasises the authority that promoters have over Indian Companies, thus rendering the detailed qualification of independent directors[30] useless.

---

[22] *Supra* at 4, Sch. IV

[23] SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, Gazette of India, pt. III sec. 4.

[24] *Supra* at 11.

[25] Avinash Kumar, *Role of Independent Director in Strengthening Corporate Governance in India vis-à-vis General Directors*, 10 CPJ L. J. 100, (2020).

[26] *Supra* at 1.

[27] *Supra* at 4, §.241, 242

[28] Janak Panicker, *Simplifying the Quandary of Corporate Governance in Light of the Tata-Mistry Saga*, 8 RFMLR 30, (2021).

[29] Shally Seth Mohile*, Is Tata Sons right in seeking Nusli Wadia's expulsion?* LIVE MINT (Nov. 17, 2016), https://www.livemint.com/Companies/gAKkMI6ycCoArsnaYfs7xJ/Is-Tata-Sons-right-in-seeking-Nusli-Wadias-expulsion.html.

[30] *Supra* at 1, §. 149(6).

The *IL&FS* case is another incident which shows how independent directors are not *performing up to standards*.[31] A similar statement was said by SFIO in the *Nirav Modi* case, as it said that three independent directors of Modi's firm *failed in their duties as independent directors*. This was because the three independent directors turned a 'blind eye' to the malfeasance committed by the four companies that were directly/ indirectly related Nirav Modi. Despite having credentials in corporate finance and audit fields, there has been gross negligence committed by these directors with respect to the manipulation of international transactions through the Punjab National Bank. Such a large-scale scam just reflects the status quo of the independent directors and also shows that the present provisions are not meeting their purpose.[32]

While corporate feuds were occurring all over India, the MCA and SEBI had been continuously amending the provisions relating to independent directors. From the institution of the Uday Kotak Committee[33] to the very latest third LODR amendment,[34] SEBI has been trying to make the system of independent directors in India more transparent and effective so that such fiascos can be avoided. Civil and Criminal liabilities were also imposed on independent directors for their negligent duties once, which caused independent directors to run away more, and therefore, the same was removed through another circular in 2020[35].

---

[31] Press Trust of India, *IL&FS crisis: Independent directors under corp affairs ministry scanner*, BUS. STANDARD INDIA, (May 15, 2019), https://www.business-standard.com/article/economy-policy/il-fs-crisis-independent-directors-under-corp-affairs-ministry-scanner-1190515011771.html.

[32] Rishi Ranjan Kala, *Nirav Modi firms' independent directors failed as mentors, says SFIO,* FIN. EXPRESS (Mar. 6, 2019), https://www.financialexpress.com/industry/nirav-modi-firms-independent-directors-failed-as-mentors-says-sfio/1506389/.

[33] SEBI, REPORT SUBMITTED BY THE COMMITTEE ON CORPORATE GOVERNANCE (2017), https://www.nfcg.in/KOTAKCOMMITTEREPORT.pdf.

[34] *Supra* at 11.

[35] MCA, GENERAL CIRCULAR NO. 1 /2020, (2020), https://www.mca.gov.in/Ministry/pdf/Circular_03032020.pdf.

On a textual reading of the provisions of the Companies Act or the SEBI regulations on independent directors, everything seems to be picture perfect, but in reality, independent directors do not seem to help in any way. Therefore, the question should not stop with the legislation, it should rather be focused on the implementation as well as on the factors or stakeholders whom the legislation affects.

B. NEED FOR INDEPENDENT DIRECTORS: EXIGENT OR REDUNDANT?

As discussed, Indian company system is based upon its UK Counterpart. Most of the provisions of the UK Companies Act are similar to the Indian legislation. The UK's corporate setup is often used by Common Law countries as a guidance model due to its acclaimed efficiency. But the Indian model that is based upon the UK's (and partly the US'), is seemingly inefficient, especially with respect to independent directors. Why is this redundancy occurring?

There are two types of company governance models: ***Outsider and Insider model***.[36] Countries like the US and the UK have an *Outsider model* which is characterised by a stark distinction between ownership and control (i.e., Shareholders and Board).[37] Whereas India follows an *Insider model*, which is heavily influenced by family-knit groups,[38] resulting in the concentration of ownership *in few hands.*[39] Since the models are totally different, the issues that arise in these models are different too:

- The *Outsider Model* suffers from the *Manager-shareholder Agency problem,* which means that shareholders' interests on the whole

[36] *Supra* at 14.
[37] *Id.* at p. 285.
[38] *Supra* at 36, p. 286.
[39] *Id.* at p. 287.

may not be reflected in the decisions of the Board.[40] In order to keep a check on the same, the concept of independent director was introduced to *monitor the board*[41] and balance the interests of the Shareholders.

- The *Insider Model*, on the other hand, suffers from the *Majority-Minority shareholder Agency problem* that arises due to the power concentration with Majority holders, hence leaving behind the interests of Minority shareholders unattended.[42]

This creates a conflict. Independent directors were created in the UK and the US to monitor the board in order to keep the Board of directors in check. This is unnecessary in India since both the Board as well as the Shareholders are dominated by the promoters, as we saw in the above cases. Even if appointed, independent directors may not be able to balance the interests of minority shareholders since they are appointed and controlled by the promoters. So, how can we justify the existence of independent directors in India? We understand that *a neutral entity* is necessary to solve the *majority-minority agency problem* in India, but to do that, the whole system would have to be revamped.

Before such a step is taken, one can analyse how another country that adopted the US-UK model has formed its corporate setup. In this aspect, the Singaporean model of independent directors will be critically analysed in the following Chapter.

[40] *Supra* at 36, p. 289-90
[41] *Id.* at p. 295
[42] *Supra* at 39.

III. ANALYSING THE PRAGMATIC PARADIGM: SINGAPOREAN MODEL OF INDEPENDENT DIRECTORS

A. UNRAVELLING THE COMPLY OR EXPLAIN MODEL

The Code of Corporate Governance is applicable to Singaporean Listed Companies and has been effective since 2019.[43] Even though the provisions of this Code are mandatory, the corporate setup in Singapore provides companies with a choice: either follow the Code, or explain how the company's deviation from the Code is in line with the objectives of the Code.[44]

There is the Companies Act that governs the corporate regime and other statutory bodies such as SGX (Singapore's stock exchange), ACRA (Accounting and Corporate Regulatory Authority), etc., which focus on Securities trading and company Compliance provisions.[45]

The Listing Manual of SGX provides the terms and provisions with regards to independent directors. In addition to this, the Singaporean system has a special policy for Whistle-blowers[46] that would ensure security and enhance corporate standards.

---

[43] Stephanie Keen et al., *Corporate governance and directors' duties in Singapore: overview,* | WESTLAW July 01, 2020), https://content.next.westlaw.com/9-502-3233?__lrTS=20210213120126590&transitionType=Default&contextData=(sc.Default)&firstPage=true#:~:text=An%20independent%20director%20is%20defined.

[44] Dan W. Puchniak & Luh Luh Lan, *Independent Directors in Singapore: Puzzling Compliance Requiring Explanation*, 65 THE AM. J. OF COMP. L. 265–333, (2017): *Board Diversity in Singapore* by Chia Yaru (2015).

[45] *Supra* at 43

[46] Singapore Exchange Regulation (SGX RegCo), *Whistleblowing*, SGX https://www.sgx.com/regulation/whistleblowing (last visited Mar 21, 2022).

B. EFFICIENCY OF THE MODEL AND ADAPTABILITY TO INDIA

It is to be noted that Singapore had incorporated the American system of independent directors earlier and had a successful increase in the country's GDP for a decade[47]. But the system was completely revamped to introduce a new model that was more suited for Singapore. It must be noted that one of the main reasons for changing an already efficient model roots back to the insider – outsider conflict.

It was understood by policymakers in Singapore that the American model wasn't working to balance the interests of minority shareholders. Independent directors lacked independence to function separately from the majority shareholders.[48] In order to change the same, Singapore introduced a new Code in 2012,[49] which in reality caused a mere "*change in form rather than function*".[50] With the *comply or explain* model, it is seen that Singaporean publicly listed companies still follow the American model mostly, which is in contrast with the 2012 Code that wanted to wipe the *American definition* off of its soil.

Critically analysing the Indian and Singaporean model of independent directors, the following can be observed:

The Indian corporate model is an *insider model* and most of the corporate giants in India who dominate the market are family-based. Since the number of tightly-knit public listed companies is increasing, it is really difficult to reduce the interference and influence of the majority shareholders in the decision-making process of the company.

---

[47] *Supra* at 44.
[48] *Id.* at 318.
[49] *Id.* at.320.
[50] *Id.*

The Singaporean model had effectively adopted the US model, although it was abandoned to create an autochthonous system to ensure that the company Setup had to suit Singapore.

It must be noted that Singapore is comparatively a capitalist country as it functions with the *comply or explain model*. It expresses how free the Singaporean Markets are, with minimal state interventions. This, however, cannot be done in India, since for a long time, the State has been an important player in the markets. It was also necessary, given that India follows Insider Model, where family-oriented companies are more prevalent. Although the comply or explain model works well in the West and Singapore, it might not work well in India, given the different models of company governance present in India.

It is therefore inferred that instead of incorporating models of other countries, setting up indigenous models in India would provide better corporate governance, since it would have been drafted keeping the Indian company environment in mind. Therefore, instead of adopting, India can learn from Singapore and introduce amendments or new regulatory bodies that would work well in its own corporate culture.

IV. REVAMPING THE INDIAN LEGAL REGIME OF INDEPENDENT DIRECTORS

A. RECOMMENDED LEGISLATIVE AMENDMENTS TO THE EXISTING SYSTEM

The research clearly shows the flaws that are present in the Indian model of independent directors and the reasons for which countries with similar economies, such as Singapore's policy decisions cannot be adopted into our country.

The research, however, indicates the necessity for independent directors, as their role ensures balanced interests of all the stakeholders. Independent directors cannot and should not be surgically removed; rather, certain new implants that may improve the system are required.

It is noted that the latest SEBI (LODR) Amendment tries to improve the system by rectifying some of the flaws that are seen as the roots of the lack of independence of independent directors. But it is also important to understand that regulations may not always provide the desired result. Independent directors already have a lot of regulations governing them, and they have the most complex set of provisions imposed among all in the company Sector. But the real problem with the system, as understood from this research and pointed out by many other articles, is the lack of transparency.

Every new amendment that was made with respect to independent directors was made with the aim of achieving more transparency in the whole process, as being an independent director per se requires a lot of transparency. Then, why is it still missing from the system?

This roots back to the *Tata-Mistry Case*[51] and many other cases that denote that the whims of corporate wheels are in the hands of majority shareholders, especially in public listed companies that are family-based. There can be many qualifications that are being given to choose an independent director effectively, but they still do end up being related to the promoters or majority shareholders in some way or the other. Clearly, the appointment is not the issue; rather, it is who is appointed.

But this process cannot be changed in the foreseeable future as the Inside model has been deep-rooted in India, and changing the same is a utopian dream. Hence, it can be established that who is appointing or

---

[51] *Supra* at 1.

who is being appointed cannot be changed. But what follows can be monitored.

Understanding the working of independent directors for almost a decade, this research proposes the following changes/amendments to the Indian model of independent directors to achieve the true purpose of the existence of independent directors:

1. National Commission of Independent Directors

The Government can institute a statutory body, preferably under the authority of SEBI or the MCA (through an amendment in the Companies Act), in order to oversee the working of independent directors throughout the country. The research proposes a statutory body for two reasons: Liability and Security.

***Liability*:** From the above analysis, it is well-established that despite the strict governance that encircles independent directors, they are still resigning and running away from their responsibilities easily. If independent directors were given more power in the board of directors or the management of the company, that would also interfere with the independence that they need to monitor the system.

The essential objective of independent directors is that they work as mentors and streamline the corporate governance of companies holistically. In order to ensure the same, the independent directors must not only be answerable to the company or only when there is a scam or corporate fraud. They must be made liable in general in order to efficiently curb corporate malpractices. But it is the fear of liability that makes most of the independent directors resign and run, as already seen.

***Security*:** In order to ensure that the independent directors don't run away from their responsibilities, there must be a system that protects them

from unreasonable sacking or unnecessary litigations against them. This would serve as a protective bubble for them to act independently as they should and carry out their functions in a company effectively.

Keeping these factors in mind, it is proposed that *instituting a commission* would ensure holistic improvement in corporate standards. This commission could perform the following roles:

- Evaluate the performance of all independent directors in India every year by asking them to submit a report on their functions in a company in the said year. (independent directors may not reveal confidential information but provide updates on the meetings they attended and how the company is functioning overall);

- Independent directors of every publicly listed company in India must submit one report every year collectively in an annual meeting that would be conducted for all the independent directors in India;

- Any misfeasance that is being detected by the independent directors shall be reported to the Commission expeditiously;

- Whistle-blowing by the independent directors shall be done through a secure mode of communication like a mobile application or a website, the credentials of which must only be available to the members of the Commission;

    - Persons other than independent directors can also report corporate misfeasance or malfeasance and inefficacy of an independent director to this commission, which would be probed by the commission expeditiously;

- The Commission shall provide security to the independent director and ensure that the whistle-blower isn't removed from their company without proper reasons;

- Independent Directors shall not resign without stating proper reasons for the same and should adhere to the Code for independent directors;[52]

- In case, independent directors are found inefficient or they resign without any proper reason, such independent director shall be barred from being an independent director for 5 years in all public companies;

- With respect to the members of the Commission, there shall be at least 3 members and a maximum of 15, with 1/3 of the Commission consisting of Judicial members who would be eligible to get appointed in NCLT;

- The judicial members of the commission may not attend the annual meeting but shall assist the non-judicial members in dissolving disputes that may occur:
    - Between two independent directors;
    - Between an independent director and the company; and
    - Due to whistle-blowing of an independent director.

- When the commission finds that there is corporate malfeasance occurring in a company, the commission shall proceed against the company in NCLT; and

- The eligibility criteria for non-judicial members are that, they should have been independent directors in any publicly listed company in India for at least 5 years or they should be a person

[52] *Supra* at 4, Sch. IV.

above the age of 50 with experience of being a director in any publicly listed company in India for at least 15 years;

2. **Other provisions incorporated as such**

It is understood that the new LODR Amendment[53] has been used as a way to improve transparency in the system. All other provisions with respect to independent directors in India can be retained, including their annual review with the Nomination and Remuneration Committee of a company. Amendments shall be made to both the Companies Act and SEBI regulations in case of the adoption of the National Commission.

B. ANTICIPATED CHALLENGES IN IMPLEMENTING THE RECOMMENDATIONS

The introduction of a statutory body in Indian company Setup might be criticized, stating that this policy decision might lead the State to interfere in company affairs to a larger extent, which might affect the autonomy of the company.

This might not be true, given the fact that India follows an inside model of corporate governance and less state interference might lead only a few to benefit in the course of their business.[54] Only 1/3 of the members of the commission are judicial in nature, while the rest are independent directors which would ensure that State interference is present in an adequate amount. Choosing of these non-judicial members can be done with the help of the Association of Independent Directors of India ("**AIDI**") and the commission can get the assistance of AIDI[55] for the better-functioning of this system. The proposed commission only functions mainly for the whistle-blowing purpose, and therefore,

---

[53] *Supra* at 11.
[54] Satyam Scam *Supra at 5*; Nirav Modi Scam *Supra* at 31.
[55] History – AIDI, AIDINDIA.CO.IN, https://aidindia.co.in/about-us/history/. (Last visited Mar. 21, 2022).

appointment, removal (other than unreasonable and unfair ones) and remuneration would continue to be vested in the hands of the company. This ensures that even though independent directors are appointed by the company, they still work independently, achieving the objective of independent directors in India, which has the majority-minority agency problem unlike the US and the UK.

V. CONCLUSION

The system of independent directors in India has a conflicting existence. This is because even though independent directors are needed to ensure balanced interest of all stakeholders, they are not able to function effectively while being dominated and controlled by the promoters/ majority shareholders. The problem can be traced back to the fact that India has an insider model of corporate governance due to most of its companies being dominated by Family-knit units. Due to this problem, the US Model of independent directors does not seem to work well in India.

While analysing the Singaporean strategy and approach to this problem, it is seen that even though they worked out an effective system of independent directors through the US model, they resorted back to an indigenous model combined with the US model, which helped to set the bench mark for the highly liquid stock exchange in Asia. This research therefore infers that, instead of a surgical addition of different corporate models into India, a self-made policy that suits India can be adopted for the achieving the aim behind independent directors. Keeping the same in mind, the research has proposed few amendments and additions to the present model, namely the National Commission of independent directors, that the researcher believes would help improve the present standards of independent directors in India and their functions.

It is therefore concluded that independent directors are needed in India and the aim behind introducing them to the corporate structure is correct. But the way in which they function after appointment must be well regulated and monitored in order to provide an effective corporate governance in India.

EXPLORING THE LACUNA OF LEAVING THE CLOSEST INSIDER, OUTSIDE THE SCOPE OF INSIDER TRADING

*Prajwal Totla**

ABSTRACT

The article attempts to elaborate on the failure of India's current insider trading regime, in particular relating to the prosecution of government. In this light, it aims to advance the argument that parliamentarians and other governmental officials, having access to certain unique information about the company and its future trajectory, should be brought under the purview of insider trading. In making this argument and consequent proposals, the article also takes inspiration from the STOCK Act in the US, which has recognized Congress officials as potential inside traders, given their access to non-public price-sensitive information.

Keyword: Trading, Insider Trading, STOCK Act, SEBI, NK Sodhi Report.

TABLE OF CONTENTS

I. INTRODUCTION 118
II. PART I: CURRENT POSITION 121
III. PART I(A): N.K. SODHI REPORT 124
IV. PART II: PROBLEMS WITH CURRENT POSITION 125
V. PART III: US' STOCK ACT 128
VI. PART IV: ANALYSING THE WAY FORWARD 131
VII. PART V: SUGGESTIONS 134

---

* The Author is a fourth year law student at Jindal Global Law School.

VIII. CONCLUSION 137

I. INTRODUCTION

The stock market has become an alluring investment option in India. It is gaining popularity as a source of income with huge potential, witnessing people from all backgrounds investing in the stock market.[1] An exponential increase of 142 lakh new accounts in the stock markets was witnessed in the last financial year of 2021.[2]

The stock market was intended to operate as a neutral platform for all buyers and sellers to facilitate the exchange of securities. The fundamental premise of such a market is to ensure equality and a common playing ground for all traders, i.e., all trades will be based on information available to all, while the analysis and interpretation of such information might differ on each's expertise. This equality and neutrality are directly vitiated by 'insider trading', when someone trades on information not known to others.[3] Given this direct negative impact such an act would have, there have been regulations to control and restrict insider trading. Section 15G of the SEBI Act provides a penalty for insider trading to *"not be less than ten lakh rupees but which may extend to twenty-five crore rupees or three times the amount of profits made"*.[4] However, one of the biggest fallacies, which the paper will

---

[1] LiveMint, *Why more and more individual investors in India are investing in stock market*, MINT (Jun. 22, 2021) https://www.livemint.com/market/stock-market-news/why-more-and-more-individual-investors-in-india-are-investing-in-stock-market-11624337297582.html; Shikhar Balwani, et al, *Millions of millennials are piling into India's stock market, shows data*, BUSINESS STANDARD (Mar. 25, 2021) https://www.business-standard.com/article/markets/millions-of-millennials-are-piling-into-india-s-stock-market-shows-data-121032500065_1.html.

[2] Shariq Zaheer, St. Bank of India, Rising retail participation in stock market: is it the beginning of a long term behavioral change? (Issue No.23, 2021).

[3] Mervyn King & Ailsa Roell, *Insider Trading,* 3 ECON. POL'Y 163, 165 (1988) [hereinafter, King & Roell].

[4] Securities and Exchange Board of India Act, No. 15 of 1992, §15G (Ind.) [hereinafter, SEBI Act 1992].

explore, is leaving the closet 'insider' out of the purview of 'insider trading'.

Members of the parliament (used interchangeably with '**parliamentarians**'), discussing and being privy to a host of information regarding amendments, new laws, or notifications that can positively or negatively impact a particular sector and even a particular company, are clearly in access of a lot of more crucial information not available to the general public.[5] This creates an asymmetry of information, but still, parliamentarians are not under the purview of insider trading.[6] To elaborate, let us consider a scenario where a new amendment bill to the income tax act is under consideration by the parliament which promotes a particular industry by increasing tax benefits and rebates in that industry. The parliamentarians would be privy to such crucial information, as to which companies would benefit from such changes and thus know those companies to invest in that have a strong potential of an increased stock price and profit on investment, once the bill is to be passed. Such information is not known to the general public to take similar decisions, which is precisely the asymmetry of information that is being referred to. A study conducted in the US highlighted that portfolios of the congressmen (members of the US parliament) beat market average by 12% points[7] and attributed this to "senators' uncanny ability to know when to buy or sell their shares seems to stem from having access to information that other investors wouldn't have".[8]

A very recent example to contextualize this could be the onset of the COVID-19 pandemic; the parliamentarians would be privy to the

---

[5] Donna M. Nagy, *Insider trading, Congressional Officials, and Duties of Entrustment*, 91 BOS.U. L. REV., 1105 (2011) [hereinafter, Nagy].
[6] King and Roell, *supra* note 3.
[7] Jane J. Kim, *U.S. Senators' Stock Picks Outperform the Pros,* WALL STREET J. (Oct. 26, 2004) https://www.wsj.com/articles/SB109874916042455390.
[8] *Id.*

regulations and restrictions to be imposed in the country. They could have accordingly sold shares in companies operating in sectors most affected by lockdowns and brought big shares in companies that would profit from such conditions, like food delivery, pharmacy, or telecommunication services. This, in fact, did happen in the US, where Georgia Senator Kelly Loeffler had sold stocks valued at around $1.275 million to $3.1 million to avoid potential losses given the coronavirus and simultaneously purchased stocks in two companies that were deemed to benefit from the coronavirus.[9] This was rather a trend followed by most congressmen, which was largely criticised "in a bizarre quirk, we've permitted our politicians to do things that we can't".[10]

The Latin maxim *"Quiscustodietipsos custodes?"* loosely translated as "Who watches the watchers?"[11] best picturises this conflict of the parliamentarians, who made laws for insider trading, leaving themselves out of the purview of such laws despite having the most price-sensitive information.[12] In this regard, the paper in **Part I** will elaborate on the current regulations that prohibit insider trading and analyse if they could be interpreted to include parliamentarians. **Part II** will continue the scheme and focus on highlighting the loopholes in the current regulations, which would in turn establish the need for change. **Part III** compares and elaborates on the situation of the US and The Stop Trading on Congressional Knowledge Act 2012 ("**STOCK Act**") in particular, the

---

9 Jack Kelly, *Senators Accused Of Insider Trading, Dumping Stocks After Coronavirus Briefing*, FORBES (May 20, 2020) https://www.forbes.com/sites/jackkelly/2020/03/20/senators-accused-of-insider-trading-dumping-stocks-after-coronavirus-briefings/?sh=1248f2c34a45.

10 *Id.*

11 John Divine, *Does Congress Have an Insider Trading Problem?*, U.S. NEWS (Aug. 6, 2020) https://money.usnews.com/investing/stock-market-news/articles/does-congress-have-an-insider-trading-problem

12 Nagy, *supra* note 5; *see* Tom McGinty & Brody Mullins, *Lawmaker Vows to Outlaw Insider Trading on the Hill,* WALL STREET J. (Oct. 12, 2010) https://www.wsj.com/articles/SB10001424052748704518104575546543960520172.

impact the act has witnessed, with the objective to understand if the STOCK Act could be a good inspiration for India to follow. In light of this, **Part IV** would critically analyse and test the practicality of certain common solutions that are proposed to negate the roadblock of parliamentary immunity. Lastly, **Part V** would explore two additional solutions that the author believes are the most feasible for the Indian context currently.

II. PART I: CURRENT POSITION

The Securities and Exchange Board of India ("**SEBI**") is the principal body entrusted with the responsibility to regulate and monitor the stock market. SEBI enacted the SEBI (insider trading) regulations in 1992 and recently amended it into SEBI (prohibition of insider trading) ("**SEBI PIT**") in 2015. In the language of SEBI PIT, insider trading can be understood to be as one undertaken by a 'connected person', 'deemed connected person', or any person in receipt of 'unpublished price sensitive information ("**UPSI**").[13] There are three key terms, each of which is defined by the SEBI PIT, and it is the collective understanding of these three terms and their ambit that determines whether someone has entered into insider trading or not.

In regards to UPSI, it is defined as information that is not "generally available", i.e., not available on a non-discriminatory basis.[14] In other words, the UPSI period would be anytime till the information is published on the website of the respective stock exchange.[15] Accordingly, it is rather clear that parliamentarians and such government officials would be privy

[13] Securities and Exchange Board of India (Prohibition Of Insider Trading) Regulations, 2015, Regulation 2(1)(g) (Ind.) [hereinafter, SEBI Regulations 2015].
[14] N.K. Sodhi, Report Of The High-Level Committee To Review The SEBI (Prohibition of Insider Trading) Regulations, 1992, Securities and Exchange Board of India, (2013) [hereinafter, N.K. Sodhi Report].
[15] SEBI Regulations 2015, *supra* note 13, Regulation 2(1)(e).

to certain confidential information much before such information is released on the stock exchange. For instance, continuing with the COVID-19 example, the imposition of lockdown and restrictions on business activities was clearly material information that had a direct impact on the prices of shares of almost every company, thus clearly being price sensitive. The parliamentarians being the ones to decide the imposition of such restrictions, obviously would know of such information much before a common man, including even company officials or traditional 'connected person'. Therefore, like the COVID-19 example, there are several similar instances where parliamentarians would be in possession of UPSI.

Regulation 2(1)(d)(i) of SEBI PIT defines a "connected person" to be "any person who is or has during the six months prior to the concerned act been associated with a company, directly or indirectly"[16] (emphasis added). It includes people in frequent conversations with the company's officials; involved in any contractual or fiduciary obligation with the company; in professional, contractual, or any relationship with the company, and any such relationship that allows access or reasonable expectation to allow access to any UPSI.[17] This is a rather broader and more expansive definition and has seen an evolution from the previous definition. However, the key term 'associated with a company' restricts the scope of SEBI PIT to an extent that it removes external members, like the parliamentarians, who still could have access to UPSI but are not connected with the Company. Further, even the other category of "deemed connected person" as provided for in regulation 2(I)(d)(ii) of SEBI PIT, further identifies ten relations, such as immediate relatives, stock market officials etc., that are presumed to make one a connected

[16] *Id.*, Regulation 2(1)(d)(i).
[17] *Id.*, Regulation 2(1)(d)(i).

person, unless the otherwise is proved.[18] However, even this list has no mention of parliamentarians or government officials.[19]

In this light, the note to the regulation[20], clarifying the intended scope, provides a much broader and unrestricted ambit to include "*those who would have access to or could access unpublished price sensitive information about any company or class of companies by virtue of* ***any connection*** *that would put them in possession of unpublished price sensitive information'*[21](emphasis added). The note uses the phrase 'any connection', which could be broad enough to argue the inclusion of parliamentarians. While discussions are ongoing within parliament about any law that impacts a specific industry or group of companies, parliamentarians may interact with the business officials on behalf of the parliament to engage with any leading industry expert to better make laws. Such interaction may also from the end of business officials lobby and promote laws that are more favourable to them. Therefore, parliamentarians could be deemed connected either through this slightly more direct mode of communication with any business personnel and not necessarily the respective company's personnel, but also connected through the general legal and economic relationships that flow between companies and such lawmakers.

Therefore, in the absence of an express mention of parliamentarians in the text of this regulation, the note could be relied upon[22], but it still is a stretch to concretely provide for the inclusion of parliamentarians, given the prerequisite to establish a connection. Thus, irrespective of the clear cases even when parliamentarians have access to UPSI, the current wording of the legislation does not offer much to include parliamentarians, even if they act and trade on UPSI.

---

[18] *Id.*, Regulation 2(1)(d)(ii).
[19] *Id.*
[20] *Id.*, Note to Regulation 2(1)(d).
[21] *Id.*
[22] *Id.*, Note to Regulation 2(1)(d).

III. PART I(A): N.K. SODHI REPORT

A high-level committee under the chairmanship of Justice (Shri.) N.K. Sodhi was formed to put forward recommendations to the SEBI regulation so as to be more predictable, precise, and clear.[23] The committee report presented several recommendations, which were largely adopted by SEBI in enacting the 2015 PIT regulations.[24]

The N.K Sodhi report also touched upon the topic of parliamentarians being included under the ambit of insider trading and suggested that "A new feature of the Proposed Regulations is that of treating public servants and persons holding statutory positions that are reasonably expected to have access to UPSI as ―connected persons and thereby prohibit them from trading when in possession of UPSI."[25] The Report actually takes this a step further and not only expressly includes parliamentarians, but by using the broader term of "public servant" provides grounds to include any and every government official who has access to UPSI.[26] In fact the report goes forward to also include judges in cases where they enter into trades, before the announcement of judgement, knowing the impact the judgment can have on either or both of the companies.[27]

This recommendation was much appreciated by the advocates.[28] However, the recommendation was not given effect by SEBI, who had

---

[23] Press Release, Securities and Exchange Board of India, Justice Sodhi Committee on Insider Trading Regulations submits report to SEBI, (Dec. 11, 2013) https://www.sebi.gov.in/media/press-releases/dec-2013/justice-sodhi-committee-on-insider-trading-regulations-submits-report-to-sebi_25863.html [hereinafter, N.K. Sodhi].
[24] *Id.*
[25] *Id.* at 20.
[26] *Id.*.
[27] *Id.*
[28] FE Bureau, *Tougher insider trading rules may bring public servants under purview*, FINANCIAL EXPRESS (Dec. 12, 2013) https://www.financialexpress.com/archive/tougher-insider-trading-rules-may-bring-public-servants-under-purview/1206579/.

'cherry-picked' recommendations[29] and conveniently choose to ignore such recommendations without any explanations.[30] While there may be several layers of a political motive behind the same, this conscious act by SEBI to not include parliamentarians within the scope of 'connected person', despite an express recommendation of the same, could be used to substantive the understating of SEBI PIT regulation 2(1)(d) to exclude such parliamentarian and public servants. This is rather contrary to the otherwise expansive view adopted by the regulation regarding the definition of 'connected person'. [31]

In the author's view, the argument of including parliamentarians as deemed connected persons could still hold water given the fact that SEBI PIT regulations in 2015 broadened the scope of 'insider' and this interpretation of including parliamentarians, is in line with such a broad understanding. It could also be that no specific mention was provided in the regulations, as it was already understood to be expansive enough to include parliamentarians. Irrespective, the absence of specific mention to include parliamentarians, will always create ambiguity and make it contingent upon the given facts of the particular case at best. This brings the paper to its second part, which further elaborates on the problems created from this absence of an explicit mention as well as procedures for adjudication of such a charge of insider trading.

IV. PART II: PROBLEMS WITH CURRENT POSITION

The biggest problem and rather a safeguard to parliamentarians in the way things stand is parliamentary immunity. The rationale behind this is to

---

[29] *Go the Whole Hog on Insider Trading,* ECONOMIC. TIMES (Nov. 21, 2014) https://economictimes.indiatimes.com/blogs/et-editorials/go-the-whole-hog-on-insider-trading/?source=app&frmapp=yes.

[30] Abhijeet Shrivastava, *Insiders in Government: Taking Stock of the STOCK Act's Message for India*, INT'L J. LEGAL STUD. RES., 84, 92 (2021) [hereinafter, Shrivastava].

[31] *Id.*

protect officials from judicial or executive intrusions into their work, or in other words, to preserve legislative independence.[32] The concept of parliamentary immunity is enshrined under Article 105(2) of the Indian constitution, which protects members of Parliament from being *"liable to any proceedings in any court"* for *"anything said or done"* in the Parliament or its committees.[33] To contextualise, let us assume that the parliamentarian receives UPSI based on an ongoing discussion regarding a new regulation that would have significant impact on a particular sector and the companies in it. Based on such UPSI, the parliamentarian makes trades to invest in the companies that would benefit from the new changes. This clearly helps the parliamentarian make profit based on UPSI, which is punishable. However, this would never be securitized or punished given the safeguard of such parliamentary immunity. Therefore, this parliamentary immunity provides means and freedom for parliamentarians to freely enter into insider trading based on UPSI, knowing that they will not be liable for such offence as it accrues from decisions in the parliament.

Further, in any case of insider trading, the charge that a person traded on UPSI will have to be factually proved. Now, in the case a member of parliament is charged with insider trading, in addition to the protection of parliamentary immunity, they would have another tool in their arsenal to deny sharing such information on grounds of breach of parliamentary confidentiality. Any such request to investigate will mandatorily have to go through an in-house procedure, which necessarily requires the particular Member of Parliament to consent to share such information,

[32] Shrivastava, *supra* note 30; *see* John Nockleby, *Immunity Under Speech or Debate Clause*, 71 HARV. L. REV. 1251 (1979).
[33] INDIA CONST. art.105(2); Dalip Singh, *Parliamentary Privileges in India*, 26 INDIAN J. POL. SCI. 75 (1965).

failing which there is no recourse.[34] Thus, in all likelihood, the investigating institutions will not be able to procure any information or evidence against the accused member of the parliament.

It must be noted that such immunity would only be applicable if there is a nexus established for it to be activities within the parliament. In the cases in which it is not, the committee of privileges is tasked to determine the appropriate immunity that the Member of Parliament would enjoy.[35] Furthermore, it must also be noted that such protection is only guaranteed to the 'legislative' sphere. Therefore, the other examples mentioned in the N.K Sodhi report, such as judges, executive members etc., can still arguably be charged with insider trading as they would not enjoy such 'parliamentary' immunity. However, scenarios of such other public servant falls outside the scope of this paper.

Therefore, even if only for the lawmakers, this blanket immunity in the context of insider trading, results in a severe miscarriage of justice as it places the lawmakers in a different position from the others, which can be argued to go against the fundamentals of equality. The larger concern remains that even if the definition of connected person can be seen to include parliamentarians as an insider, or an amendment is made to make an express recognition of the same, this procedural roadblock of parliamentary immunity would ensure the status quo. To substantiate this, the paper would elaborate on the real-life example of the impact the US STOCK Act has had, which does provide inspiration to an extent but fails on this larger level, resulting in no 'substantive' headway in this area.

[34] V.S. RAMA DEVI & B.G. GUJAR, RAJYA SABHA AT WORK, 246 (Shumsher K. Sheriff ed., 2017); Shrivastava, *supra* note 30.
[35] *Id.*

V. PART III: US' STOCK ACT

In the United States, the situation before the enactment of the STOCK Act was similar to that of India currently, i.e., there was no statutory law that prohibited members of congress to engage in insider trading. The first draft of the STOCK Act was introduced as early as 2006 but was rejected and it also failed to advance in 2007 and 2009 when it was again re-introduced.[36] It was only six years later when the bill was passed unanimously by the Senate on March 22, 2012 and signed by President Barack Obama on March 28, 2012, that the STOCK Act came into force.[37]

The sudden change in congress approving the STOCK Act was largely a political decision.[38] In 2012, the election year, a report highlighting how senators had profited from the 2008 financial crisis by virtue of information obtained through their Congressional working, had resulted in massive public outrage.[39] Further, other studies also broke out that highlighted how senators on average earned 'abnormal' results of over twelve per cent on their securities, in comparison to which even corporate insiders' profits paled at six per cent.[40] In this background, congress with elections around the corner, wanted to re-establish faith, trust and accountability in the eyes of the public, and hence the STOCK bill was speedily passed.

---

[36] Joshua Michael Brick, *The STOCK Act: Is It Necessary and If So Is It a Sufficient Solution?*, 15(2) BUS. L. J. 179, 187 (2013) [hereinafter, Brick].

[37] *Id.*

[38] Brick, *supra* note 36; Gwen Seaquist et al., *Congressional insider trading runs deep will the stock act only skim the surface?*, 29 NORTH EAST J. LEGAL STUD. (2013) [hereinafter, Seaquist et al.]

[39] *Id.*

[40] Brick, supra note 36; *see* Stephen M. Bainbridge, *Insider Trading inside the Beltway*, 36 J. CORP. L. 281 (2011); Alan J. Ziobrowski et al., *Abnormal Returns from the Common Stock Investments of the members of the U.S. House of Representatives*, 13 BUS. AND POL. (2011)

This similar public awareness or outrage has not yet happened in India, which might be one of the most practical reasons why there is no development or eagerness shown from the parliament, and logically so, towards hampering their own financial benefits that they have been enjoying without objection.[41] One of the prerequisites for any fundamental change is the public support that puts pressure on the parliament to hold itself accountable in order to re-establish public faith. However, this is a larger discussion, beyond the scope of this paper and hence this reflection apart, it is appropriate now to critically analyse the provision of the STOCK Act.

The STOCK Act, under S.4(b), provides that "Each Member of Congress or employee of Congress owes a duty arising from a relationship of trust and confidence … with respect to material, non-public information derived from such person's position as a Member of Congress or employee of Congress or gained from the performance of such person's official responsibilities".[42] Consequently, the STOCK Act was appreciated to the extent it cleared the unambiguity and affirmatively recognised members of the congress as insiders.

In enforcing this fiduciary relationship that was introduced, the STOCK Act cast a duty on the congressmen to fill financial disclosure forms that would be publicly available on the official websites of the respective members of the Senate and the House of Representatives.[43]The act amends the Ethics in Government Act of 1978 ("**EIGA**") to require that all Members and employees must report any stock trades greater than $1000.00 within 30 days, rather than once a year.[44]

---

[41] Shrivastava, *supra* note 30.
[42] The Stop Trading on Congressional Knowledge Act 2012, §.4(b) (U.S.).
[43] *Id.*, §.8(a)(i) (U.S.); Brick, *supra* note 36.
[44] Brick, *supra* note 36, at 184.

However, this might be a toothless tiger as the STOCK Act solves the concern to an extent by recognising the congressmen as insiders, but does not provide any effective resolution, the scope for punishment or procedures that could be enforced to penalise congressmen. The Act merely enforces a fiduciary duty and trusts that such duty will be performed in good faith.[45]

The roadblock posed by the concept of parliamentary immunity elaborated in Part II still remains unsolved by the STOCK Act. Even in the US, Article I, Section 6 of the U.S. Constitution provides Members of Congress immunity under the "Speech or Debate Clause" for acts which they perform in the exercise of their duties.[46]Additionally, for the U.S. Securities and Exchange Commission ("**SEC**") to embark on an investigation, they would have to require subpoenas to be issued permitting them to access respective legislative discussions or meetings, which are generally protected under the speech clause.[47] Therefore, despite the STOCK Act, the parliamentary immunity from any charges as well as investigations poses the most fundamental obstacle to successfully prosecuting congressmen for insider trading.

Notwithstanding this shortfall, the empirical effect of the act still is quite impressive. While there still hasn't been a successful SEC investigation, the reason for which could be political, instances of insider trading has been reduced to less than half and the average amount of the transactions has reduced eight-fold.[48] This can be the result of the deterrence effect that the act poses by highlighting the crime of insider trading by parliamentarians, opening it up for scrutiny by the larger public

---

[45] Seaquist et al., *supra* note 38.
[46] *Id.*; U.S. CONST. art. 1, §.6(1)
[47] Seaquist et al., *supra* note 38.
[48] *The Impact of the STOCK Act on Stock Trading Activity by U.S. Senators, 2009 – 2015*, PUBLIC CITIZEN, (2019).

and thus making the congressmen choose between retaining the faith of its electorate or unfair financial gains.

However, it could also be that the congressmen have explored new ways, that are more silent and discreet, to enter into transactions based on UPSI, such as trading through other related family members, through a third party agent or similar others. It could also simply be that there has not been enough material or investigation conducted into such actions by congressmen, given the protection of parliamentary immunity, as there has not been any recent official publication by the government giving numbers or details to actually understand if the STOCK Act has had a long-lasting, continuous impact, which it intended.

VI. PART IV: ANALYSING THE WAY FORWARD

The preceding parts establish how even if there is an express recognition of insider trading that India adopts, parliamentary immunity would be the biggest obstacle to effective prosecution. In this regard, the SEBI certainly has the power to make regulations in furtherance of its purpose, to ensure fair trading.[49] However, this power is not absolute and any regulations made would be subject to parliamentary supervision.[50] Thus, the parliament, upon approval by both of its houses, can modify or reject any regulation with which it disagrees with.[51]

Accordingly, it is very unlikely that in a practical scenario, *firstly* that SEBI itself comes up with regulation that places insider trading by parliamentarians outside the protection of parliamentary immunity. *Secondly*, even if they do so, it's very unlikely that such regulation, severely hampering parliamentarians' monetary profits, will be approved by the

[49] SEBI Act 1992, *supra* note 4, §.30.
[50] SEBI Act 1992, *supra* note 4, §.31.
[51] *Id.*

parliament.[52] In any event, the concept of parliamentary immunity being provided in the Constitution, the highest law of the land, cannot be contravened by a delegated body like the SEBI. Further, this immunity has been recognised as the fundamental principle of a Parliamentary system by the Supreme Court, which held this absolute safeguard "is as it should be".[53] Therefore, a suggestion to the end for SEBI to enact a waiver of parliamentary immunity is not only legally futile but also unrealistic.[54]

There has been an alternative suggestion made regarding a blanket ban on parliamentarians trading in securities.[55] The justification for this was premised on the larger duty that members of parliament owe towards the general public, with a much higher level of fiduciary duty than any other corporate insider.[56] This would also help in resolving issues of any potential conflict of interest, and provide a neutral ground to parliamentarians to decide on legislation on merit rather than in a manner which may materially benefit their existing portfolios.[57] There is certain merit to this argument resting largely on the weighing of duties as parliament over private gains for such members.

However, there are a couple of concerns even with this solution. *First*, the same argument that was posed for parliamentary immunity – that parliament would not be keen on taking measures against its own monetary interest. Especially, as the parliament is the only authority that can decide to pass a bill imposing such a ban on itself, the successful

[52] Shrivastava, *supra* note 30, at 97.
[53] Tej Kiran Jain v. N. Sanjiva Reddy, AIR 1970 SC 1573 (Ind.)
[54] Shrivastava, *supra* note 30, at 96.
[55] Tyler Gellasch, *I Helped Write the STOCK Act. It Didn't Go Far Enough,* POLITICO (Mar. 25, 2020) https://www.politico.com/news/magazine/2020/03/25/congress-stock-trade-148678.
[56] Shrivastava, *supra* note 30, at 99.
[57] Brick, *supra* note 36, at 196.

approval of such a measure unless for a larger public outrage regarding the same, remains remote.

Second, there were arguments opposing such a ban stating that this may disincentivise the "best and brightest from seeking office" given its drastic nature.[58] The author does not agree with this as the main purpose of an aspiring parliamentarian should be to serve its people and in furtherance of the same, loss of such ancillary privileges may seem justified. Rather, such a blanket ban could act as a filter to test the dedication or motivation of aspiring parliamentarians, i.e., if they are willing to subordinate their personal interest to larger public welfare.

Third, there was also a concern that this would portray a lack of ethics being the general presumption.[59] However, in the author's opinion the proactive step to resolve any such possible conflict or suspicion and place public interest and equality above personal gains, would only be a testament of ethics showcased by the parliament. This would in turn also boost public trust that the parliament are self-checking them and ensuring ethical conformity despite any provision to the same. *Fourth*, mainly there could be a legal argument to the end that such a ban would violate the fundamental right to trade. That would be contingent on whether it can be established that such a ban is a reasonable restriction. However, this discussion is a larger argument beyond the scope of the paper.

Therefore, while most arguments against such blanket bans are not completely satisfactory, the author nonetheless agrees that the blanket ban seems much far-fetched given that India is still in its nascent stages to recognise insider trading by members of parliament, and an extreme measure of a blanket ban with the current situation is only quixotic. Accordingly, the paper would now shift to lastly explore other suggestions

---

[58] *Id.*; *See* Shrivastava, *supra* note 30

[59] Shrivastava, *supra* note 30, at 99.

on imposing prohibition on members of parliament concerning insider trading.

VII. PART V: SUGGESTIONS

Interestingly, even the N.K. Sodhi report did not provide any alternative recommendation on the enforcement or procedural aspect of the prosecution of parliamentarians and only limited itself to suggesting the inclusion of public servants in the definition of a connected person. This could possibly highlight the difficulty in introducing a legitimate solution that has to circumvent the obstacle of parliamentary immunity. However, the paper would best attempt to put forward two suggestions, that the author feels could be most practically implemented.

First, allow the members of parliament to act based solely on 'trading plan'.[60] A trading plan is simply a document prepared in advance, based on the existing market research, which outlines the trades which a person is going to enter into. In principle it attempts to safeguard trades that can be traced and backed by prior research rather than any subsequent discovery of UPSI. The concept of a trading plan prepared in advance is not novel, and is already recognised as an exception to the offence of insider trading under regulation 4(1)(vi).[61] Regulation 5 further elaborates on such trading plan and provides that a trading plan must be submitted six month in advance and is subject to review by a compliance officer.[62] The rational for a six month gap, termed as 'cooling off period' is to provide *"for unpublished price sensitive information that is in possession of the insider when formulating the trading plan, to become generally available."*[63] It is to ensure that trades are based on market acumen, knowledge or research and not UPSI. This is based on premise that the UPSI will become either

[60] Shrivastava, *supra* note 30, at 100.
[61] SEBI Regulations 2015, *supra* note 13, Regulation 4(1)(vi).
[62] *Id.*, Regulation 5(1) and 5(2).
[63] *Id.*, Note to Regulation 5(1).

irrelevant or publicly available in the span of six month. However, while the same may be true in the corporate sector, it might not be the same in the legislative arena, especially in India, where discussions of bills prolong for a long period. Therefore, while the trading plan could be beneficial first step by imposing duty on members of parliament to only trade based on pre-decided trades, there must be an amendment to the time duration of the 'cooling off period'.

There might be certain bills passed much more expediently and others might take longer than usual. Thus, in the author's view, instead of providing a definitive time period, the cooling off period could be defined in terms of either passing off the bill or rejection, i.e., the moment it is publicly announced. Further, to ensure that parliamentarians are not in possession of the UPSI while making such trading plans, it can be an additional duty to not provide for trades relating to the industry which has a major bill in discussion. Again, as there can't be disclosure of what bills are pending in the parliament unless by parliament's consent to protect parliamentary confidentiality, this could rather be projected as a good faith duty on the parliamentarians to draft trading plans solely based on their market acumen. This in other sense, can be seen as imposing a partial reasonable ban to the extent of only a particular bill in discussion, till the period it is passed or disposed of, if it is reasonably likely that the bill will have a significant impact on the security market.

Second, the concept of 'concealed trust' can be adopted.[64] The idea is that you completely trust an agent or external third party for trading on behalf of the parliamentarian, and there is no communication or direction whatsoever with this agent and the parliamentarian. If this has to function, then this should be different from the general understanding of a broker who trades on behalf of others, on advice or direction of his client. The agent here must himself have complete authority to trade and mandatorily

[64] Shrivastava, *supra* note 30, at 101.

will not be receiving any direction from the client (parliamentarian). While it is acknowledged that the congress has already rejected this idea in the past[65], the author still believes in its merit and advocates it as a balanced solution to the problem at hand.

The concealed trust does not take away partially or wholly the right to trade in securities from the members of the parliament, nor is it hit by the obstacle of parliamentary immunity as it is undertaken by completely different persons who do not enjoy any such safeguard. Therefore, unlike normal traders, the parliamentarians would lose out on the right to direct their trade and determine how they wants to invest their money, but it seems like a fair trade off given the competing larger interest to promote public faith and trust.

Further, the parliamentarians can still have discretion on who they want to appoint as their agent to enter into trading on their behalf that best fits their interest. They could also give the agent so appointed, general tips and guidelines which he has to follow while trading. For example, they can provide guidelines like no blue chip stocks are to be sold and to keep on increasing holding in such companies regularly. This is only indicative to illustrate that members of the parliament can have a reasonable opportunity to enter into trading securities while also maintaining their parliamentary integrity through this solution of concealed trust.

The only basic foundational element for this to work is that there has to be no communication of any form, post the appointment of the agent with the members of the parliament. This also seems like a much easier ground to check and supervise by the SEBI as communication of members of parliament with such external members, especially agents for trading, is not protected by any parliamentary immunity or safeguard,

---

[65] Seaquist et al., *supra* note 38.

hence would be much easier to investigate and identify if breach of the same has taken place.

VIII. CONCLUSION

In the current scenario, members of parliament enjoy a free pass to engage in insider trading. To change this position, there must be a step by step process adopted and this must be complemented by great public support. The first step must necessarily begin with recognising parliamentarians as insiders explicitly in the SEBI PIT. However, this merely would be the first step and cannot completely transform the position. This is because members of parliament have the absolute safeguard from prosecution as well as investigation on grounds of parliamentary immunity. In this regard, India could take learnings from the US and the implementation of the STOCK Act. While the act recognised parliamentarians as insiders and took an appreciated first step, but it failed to provide measures and procedure to effectively prosecute congressmen and hence was deemed insufficient.

Thus, even if parliamentarians are recognised as insiders, there must also be a procedure provided that can circumvent the safeguard of parliamentary immunity. Given India is in a nascent stage with respect to recognising parliamentarian as insiders, an extreme measure cannot practically be feasible. The paper intends to act as a catalyst to facilitate further discussion in this area and does not propose definitive solutions or findings.

In conclusion, while it is clearly difficult to find a solution to move away from something as fundamental and expansive as parliamentary immunity, efforts and dialogue must continue, as only with such regular efforts, discussion and public support, will the position transform to one of a fair trading ground for everyone.

ISSN: 0976-0369

Published By;

The Registrar,

National Law University Jodhpur,

NH-65, Mandore,

Jodhpur - 3424304

Rajasthan, India

journal.governance@gmail.com//nlu-jod-rj@nic.in