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Afra Afsharipour

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Abstract: Over the past two decades, corporate governance reforms have emerged as a central focus of corporate law in countries across the development spectrum. Various legal scholars studying these reform efforts have engaged in a vigorous debate about whether globalization will lead to convergence of corporate governance laws toward one model of governance: namely the Anglo-American, dispersed shareholder model, or whether existing national characteristics will thwart convergence. Despite rapid economic growth and reforms in developing countries such as India, the legal literature discussing this debate primarily focuses on developed economies.

This Article examines recent corporate governance reforms in India as a case study for evaluating the competing claims on global convergence of corporate governance standards currently polarizing the field of corporate law. This Article seeks to make a fresh contribution to the convergence debate by examining the implications of India's corporate governance reform efforts. It contends that the Indian experience demonstrates that traditional theories predicting convergence, or a lack thereof, fail to fully capture the trajectory of actual corporate governance reforms. India's reform efforts demonstrate that while corporate governance rules may converge on a formal level with Anglo-American corporate governance norms, local characteristics tend to prevent reforms from being more than merely formal. India's inability to effectively implement and enforce its extensive new rules corroborates the argument that comprehensive convergence is limited, and that the transmission of ideas from one system to another is highly complex and difficult, requiring political, social and institutional changes that cannot be made easily.

[*]Acting Professor of Law, University of California, Davis, School of Law; B.A., Cornell University; J.D., Columbia Law School. The author gratefully acknowledges Stephanie Afsharipour, Keith Aoki, Katherine Florey, Deep Gulasekaram, Thomas Joo, Courtney Joslin, Tayyab Mahmud, Shruti Rana, Patricia A. Seith, Diego Valderrama, and Jarrod Wong for their valuable insights on this article. The author is also grateful for comments and suggestions received at workshops at the law schools of UC Davis, Seattle University, University of Richmond, Miami University, California Western, Southwestern, and Ohio State, as well as at the Conference of Asian Pacific American Law Professors at University of Denver School of Law. Dean Rex Perschbacher and Dean Kevin Johnson provided valuable institutional support for this project, and Elizabeth Donald, James Harvey, and Fenny Lopez provided excellent research assistance.

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INTRODUCTION

Over the past two decades, countries across the development spectrum have instituted corporate governance reforms. These reforms have been propelled both by corporate scandals and a greater global focus on corporate governance. While corporate governance reforms have long been a central issue in developed economies, developing economies are increasingly playing major roles in the corporate governance arena.

One result of these corporate governance reforms around the world has been the emergence of a vigorous debate about the scope and nature of different corporate governance standards.[1] A key portion of this debate concerns whether globalization will lead to convergence of corporate governance laws toward one model of governance. Proponents of the convergence theory generally argue that corporate governance laws are converging around the shareholder-oriented Anglo-American model, in part because they view this model as most efficient.[2] Others argue that the Anglo-American model has not been widely adopted for a variety of reasons, including that existing governance systems are not easily changed due to path dependent choices—i.e., that past or traditional practices tend to persist even if better alternatives are available, or, more broadly, that "history matters."[3]

A wealth of literature has been written in the finance field addressing convergence both generally and with a focus on country-specific case studies from a variety of economies, including numerous emerging

[1] *See, e.g.*, CONVERGENCE AND PERSISTENCE IN CORPORATE GOVERNANCE (Jeffrey N. Gordon & Mark J. Roe eds., 2004).

[2] *See, e.g.*, Paul Davies & Klaus Hopt, *Control Transactions, in* THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 157, 172 (Reinier Kraakman et al. eds., 2004) (stating that regulation of control transactions is "a timely reminder that 'Anglo-American' company law is not the unity that is sometimes assumed"); Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439 (2001); *see also* Darryl Reed, *Corporate Governance Reforms in Developing Countries, in* CORPORATE GOVERNANCE, ECONOMIC REFORMS, AND DEVELOPMENT 10 (Darryl Reed & Sanjoy Mukherjee eds., 2004). However, there is some debate as to whether a standardized Anglo-American model of corporate law even exists. John Armour & David A. Skeel, *Who Writes the Rules for Hostile Takeovers, and Why? The Peculiar Divergence of U.S. and U.K. Takeover Regulation,* 95 GEO. L.J. 1727 (2007).

[3] *See* Jeffrey N. Gordon & Mark J. Roe, *Introduction, in* CONVERGENCE AND PERSISTENCE IN CORPORATE GOVERNANCE 1, 11 (Jeffrey N. Gordon & Mark J. Roe eds., 2004) (explaining that, as opposed to the systemic convergence model of corporate governance, some systemic persistence scholars are "skeptical that corporate governance and ownership structures have converged thus far, and they argue that structural imperatives help to explain why differences have persisted thus far, despite convergence in many economic areas.").

economies.[4] In contrast, the legal literature analyzing specific corporate governance reforms in emerging economies is fairly limited.[5] For example, in their comparative study of corporate law, Professor Reinier Kraakman and other renowned corporate law scholars focus on developed economies to the exclusion of corporate law in emerging economies.[6] This dearth of analysis is unfortunate because an examination of emerging legal norms in developing economies can enrich and enlighten the convergence debate. At a minimum, careful study of governance reforms in developing countries can help us determine whether the Anglo-American model is replicable—that is, whether there can be global convergence towards the Anglo-American model. Illuminating the path and results of corporate governance reforms in a country like India provides important lessons for reform efforts in other countries.

This Article aims to address this gap. It explores the recent wave of corporate governance reforms in India as a case study for evaluating and exploring the corporate governance convergence debate. Using the Indian

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[4] *See, e.g.*, Rafael La Porta et al., *Law and Finance*, 106 J. POL. ECON. 1113 (1998); Rafael La Porta et al., *Investor Protection and Corporate Governance*, 58 J. FIN. ECON. 3 (2000) [hereinafter La Porta et al., *Corporate Governance*]; Rafael La Porta et al., *Investor Protection and Corporate Valuation*, 57 J. FIN. 1147 (2001); Rafael La Porta et al., *Legal Determinants of External Finance*, 52 J. FIN. 1131 (1997) [hereinafter La Porta et al., *Legal Determinants*]; Rafael La Porta et al., *What Works in Securities Laws?*, 61 J. FIN. 1 (2006); Craig Doidge, G. Andrew Karolyi & Rene M. Stulz, *Why Do Countries Matter So Much for Corporate Governance?*, (ECGI—Finance, Working Paper No. 50/2004, November 2006), *available at* http://ssrn.com/abstract=580883.

[5] *See, e.g.*, Bernard S. Black & John C. Coffee, Jr., *Hail Britannia?: Institutional Investor Behavior Under Limited Regulation*, 92 MICH. L. REV. 1997 (1994); Ronald J. Gilson & Curtis J. Milhaupt, *Choice as Regulatory Reform: The Case of Japanese Corporate Governance*, 53 AM. J. COMP. L. 343 (2005); Ronald J. Gilson & Mark J. Roe, *Understanding the Japanese Keiretsu: Overlaps Between Corporate Governance and Industrial Organization*, 102 YALE L.J. 871 (1993); Mark J. Roe, *Some Differences in Company Structure in Germany, Japan, and the United States*, 102 YALE L.J. 1927 (1993). Comparative studies of corporate governance convergence in developing or emerging economies are fairly preliminary. *See, e.g.*, Ethiopis Tafara, *A Race to the Top: International Regulatory Reform Post Sarbanes-Oxley*, INT'L FIN. L. REV. (2006).

[6] *See* David A. Skeel Jr., *Corporate Anatomy Lessons*, 113 YALE L.J. 1519, 1522 (May 2004) (reviewing THE ANATOMY OF CORPORATE LAW, *supra* note 2). While acknowledging that his casebook excludes a study of corporate governance in most developing economies, Professor Backer also notes that "[o]ther systems of corporate governance are also worthy of study. The governance systems of Latin America, the Indian subcontinent and Africa merit discussion in their own right." LARRY CATA BACKER, COMPARATIVE CORPORATE LAW: UNITED STATES, EUROPEAN UNION, CHINA AND JAPAN: CASES AND MATERIALS xxxvii, n.2 (2002). Similarly, in their recent book "Convergence and Persistence in Corporate Governance," Professors Gordon and Roe recognize that "corporate governance is on the reform agenda all over the world," Jeffrey N. Gordon & Mark J. Roe, *Introduction*, *in* CONVERGENCE AND PERSISTENCE IN CORPORATE GOVERNANCE 1, 1 (Jeffrey N. Gordon & Mark J. Roe eds., 2004), but the focus of much of the comparative analysis in their work remains on developed economies. *See* CONVERGENCE AND PERSISTENCE, *supra* note 1.

context, this Article argues that the trajectory and results of corporate governance reforms in India demonstrate that extensive governance reforms can converge on a formal level to a considerable extent with traditional notions of the Anglo-American model. Nevertheless, lapses in the enforcement and widespread implementation of these rules reveal that India's corporate governance reform efforts, at least on the ground, show a lack of comprehensive convergence to the Anglo-American model. India's inability to effectively implement and enforce its robust new rules corroborates the argument that comprehensive convergence is limited and that the transmission of ideas from one system to another is highly complex and difficult, requiring political, social, and institutional changes that cannot be made easily. This Article contends that the Indian experience demonstrates that traditional theories predicting convergence, or a lack thereof, fail to fully capture the trajectory of actual corporate governance reforms. Rather, this Article argues that, as demonstrated by the Indian reform experience, a mixed system of governance can emerge and corporate governance reforms can be better understood through a view of convergence as a continuum.

India is, for a number of reasons, a particularly useful case study for analyzing the competing claims of the convergence debate. If complete convergence to the Anglo-American model could occur in a developing economy, India would be the perfect testing ground. India has experienced exponential economic growth in the past decade, striving to become a global economic leader. This growth has resulted in a transformation of Indian companies, with significant demand for new capital.[7] The largest Indian companies are striving to be global corporate actors and have attempted to access capital markets both inside and outside of India.[8] Institutional investors, including foreign institutional investors, are making inroads in the ownership of Indian firms.[9] Moreover, the Indian government has increasingly opened up the economy to foreign direct

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[7] *See* Pratip Kar, *Corporate Governance in India*, *in* CORPORATE GOVERNANCE IN ASIA: A COMPARATIVE PERSPECTIVE 249, 251, 272–73 (Org. for Econ. Co-Operation and Dev. Ed., 2001).

[8] *See* TARUN KHANNA, BILLIONS OF ENTREPRENEURS: HOW CHINA AND INDIA ARE RESHAPING THEIR FUTURE AND YOURS (2007). India's capital markets have experienced a surge of initial public offerings (IPOs). According to Thomson Financial, Indian companies expect to raise over $14 billion in the first half of 2008, compared with $4.6 billion in the same period in 2007. *See Power Play*, ECONOMIST, Jan. 19, 2008, *available at* http://www.economist.com/finance/displaystory.cfm?story_id=10534942; Orit Gadiesh & Sri Rajan, *Looking at Acquisitive India: An M&A Scorecard*, ECON. TIMES, Dec. 10, 2007, http://economictimes.indiatimes.com/articleshow/2609678.cms.

[9] Pitibas Mohanty, *Institutional Investors and Corporate Governance in India*, (2003) (unnumbered working paper), *available at* http://unpan1.un.org/intradoc/groups/public/documents/APCITY/UNPAN023823.pdf.

investment (FDI).[10]

The needs of India's expanding economy, including access to FDI, the increased presence of institutional investors (both domestic and foreign) in India, and the growing desire of Indian companies to access global capital markets by gaining listing on stock exchanges outside of India, have spurred corporate governance reforms.[11] Thus, India's rapid economic transformation has been accompanied by significant reforms in its corporate governance laws. Beginning in the late 1990s, the Securities and Exchange Board of India (SEBI), the primary regulatory authority for India's capital markets, formed a number of committees to help formulate corporate governance standards for publicly listed Indian companies. After lobbying by large firms and a governance code proposed by a leading industry group, in 2000, SEBI introduced unprecedented corporate governance reforms via Clause 49 of the Listing Agreement[12] of Stock Exchanges (Clause 49).[13] These reforms were phased in over several years, and now apply to thousands of listed Indian public companies.

Clause 49, which has been described as a "watershed event in Indian corporate governance," established a number of corporate governance requirements with a focus on corporate boards and disclosure to shareholders.[14] The main components of Clause 49 are summarized in the Appendix. Many of its provisions—such as a minimum number of independent directors, independent audit committees, and CEO/CFO certification of financial statements, internal controls and disclosure with respect to governance matters—were derived from governance reforms adopted in developed countries, especially those in the United States and the United Kingdom. On the surface, Clause 49 thus moved India toward formal convergence to the Anglo-American model. However, Indian regulators have been less successful in implementing and enforcing Clause 49's extensive standards than in establishing them. Despite much fanfare

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[10] After decades of prohibitive policies on FDI, India's current "foreign investment policy . . . is approximately as open as that of China." ARVIND PANAGARIYA, INDIA: THE EMERGING GIANT 107 (2008).

[11] *See* Bernard S. Black & Vikramaditya S. Khanna, *Can Corporate Governance Reforms Increase Firms' Market Value: Evidence from India* 9 (Univ. of Mich. Law Sch., Olin Working Paper No. 07-002, Oct. 2007), *available at* http://ssrn.com/abstract=914440.

[12] The Listing Agreement with stock exchanges defines the rules and processes that companies must follow in order to remain listed companies on an Indian stock exchange. *See* Black & Khanna, *supra* note 11, at 9.

[13] CIRCULAR, SECURITIES AND EXCHANGE BD. OF INDIA, AMENDMENTS TO CLAUSE 49 OF THE LISTING AGREEMENT (Sept. 12, 2000), *available at* http://web.sebi.gov.in/circulars/2000/CIR422000.html (reporting changes in response to Birla Report); CIRCULAR, CORPORATE GOVERNANCE IN LISTED COMPANIES—CLAUSE 49 OF THE LISTING AGREEMENT (Aug. 26, 2003), *available at* http://web.sebi.gov.in/circulars/2003/cir2803.html [hereinafter CLAUSE 49 (2003)] (reporting changes in response to Murthy Report).

[14] Black & Khanna, *supra* note , 11 at 5.

and threats of vigorous enforcement, Indian regulators have not yet instilled Clause 49's corporate governance across corporate India.[15]

This Article argues that path dependent forces in India's political, economic, and social framework have created a corporate governance environment that only formally mirrors Anglo-American governance principles. These forces include the lack of an effective regulator, the inability of shareholders to effectively enforce corporate law through the judiciary, the complex concentrated ownership structures of Indian firms, and political pressures related to government ownership of certain major industries.

This Article is organized as follows. Part I presents a brief overview of corporate governance convergence. This section examines the two leading models of corporate governance and outlines the debate about convergence in the corporate governance context.

Part II first offers a brief overview of the political economy of India designed to familiarize the reader with the country's recent economic transformation. Part II then presents a summary of India's legal tradition as well as the legislative and regulatory framework applicable to public companies in India. It also discusses the traditional ownership structures of Indian firms.

Part III explores India's recent corporate governance reforms. It examines India's regulatory reforms and demonstrates that India's governance rules resemble and are largely derived from recent corporate governance reforms in the United States and the United Kingdom. Indeed, India's reforms illustrate that convergence to the Anglo-American model of corporate governance has occurred at a formal level. Part III then takes a deeper look at corporate governance reforms in India and establishes that formal convergence has not led to substantive convergence. To illustrate the weaknesses in India's corporate governance regime, Part III examines recent flawed efforts to implement and enforce Clause 49.

In Part IV, this Article argues that these weaknesses will persist because they have been shaped by unique political and social forces. These forces include the traditional closed ownership structures of Indian firms, an ineffective institutional framework to support enforcement efforts, weaknesses in the judiciary, and political pressures related to government ownership of certain industries. These weaknesses suggest that corporate

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[15] At the end of 2008, India experienced a massive corporate governance scandal involving Satyam Computer Services, one of India's largest technology companies. *See* James Fontanella-Khan, *Timeline: The Satyam Scandal*, FIN. TIMES, Jan. 7, 2009, http://www.ft.com/cms/s/0/24261f70-dcab-11dd-a2a9-000077b07658.html. The Satyam scandal has been described as India's Enron. See *India's Enron*, ECONOMIST, Jan. 8, 2009, *available at* http://www.economist.com/business/displaystory.cfm?story_id=12898777. It remains to be seen whether the massive fraud at Satyam is an aberration or a sign of greater systemic problems.

governance in India may be unable to move past merely a formal level of convergence, and at the least, the rate of convergence from formal to comprehensive will be impeded. This Part concludes with a discussion of the implications of India's corporate governance experience for the convergence debate.

I. THE CORPORATE GOVERNANCE CONVERGENCE DEBATE

A. Comparative Corporate Governance: A Brief Overview

Corporate governance is broadly defined as "a set of relationships between a company's board, its shareholders, and other stakeholders."[16] A narrower view that has traditionally influenced corporate law and governance standards defines corporate governance as "the ways in which suppliers of finance to the corporation assure themselves return on their investment."[17] According to this view, the corporate entity is a means by which investors and managers allocate rights and responsibilities.[18] Thus, in keeping with this latter view of the corporation, corporate law and corporate governance standards primarily address the agency costs that arise as a result of the divergence of interests between managers and owners (shareholders).[19] In order to reduce agency costs, corporate governance rules broadly address, among other matters, powers, structures, and relationships among various participants in the corporate entity, namely the board, shareholders, and managers. Given this concern with ownership and principal-agent issues, a central focus of corporate governance rules has been the structure and role of the corporate board.

Contemporary scholarship regarding corporate governance generally identifies and studies two distinct corporate governance regimes. In what has been termed as a regime of "closed governance," corporations have concentrated ownership with controlling shareholders, such as the state, financial institutions, or wealthy family groups, who maintain power over the firm's managers. In contrast, an open ownership regime or dispersed ownership model features arm's length relationships between shareholders

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[16] OECD, PRINCIPLES OF CORPORATE GOVERNANCE (1999).

[17] Andrei Shleifer et al., *A Survey of Corporate Governance*, J. FIN. 737, 773 (1997).

[18] THOMAS W. JOO, CORPORATE GOVERNANCE: LAW, THEORY AND POLICY 3 (2004). The classic work of Berle and Means highlighted the agency problems inherent in the separation of ownership (shareholders) and control (managers). *See* ADOLPH BERLE & GARDNER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 6–7 (rev. ed. 1968). Berle and Means found an inherent potential for a conflict of interest between the owners of a limited liability company (often small and dispersed) and its paid managers. Managers should act in the interest of owners and in the most economically efficient way, but often do not (the "agency conflict" problem) because they do not always reap the profits of such actions. *Id.* at 115.

[19] JOO, *supra* note 18, at 3.

and managers.[20] This dispersed ownership model is also shaped by the shareholder primacy norm.[21] Companies in countries with a concentrated ownership model rely heavily on controlling shareholders for financing the firm and monitoring the managers, while those in the dispersed ownership model rely on market financing and liquidity.[22] The open regime is said to prevail in the Anglo-American economies of the United States, the United Kingdom, and Ireland, while the closed governance regime persists in much of the rest of the world, including the continental European economies and Japan.[23]

B. The Convergence Debate in Corporate Governance

A vast academic inquiry has emerged, particularly at the intersection of law and economics, regarding whether globalization and increasing financial integration have led to convergence of corporate governance standards across countries.[24] Numerous scholars have studied the

[20] Corporate forms in common law countries, such as the U.K. and the U.S., are often defined as "shareholder-oriented" because of their focus on shareholders' interests. For greater discussion of the characteristics of the shareholder-oriented model, see Hansmann & Kraakman, *supra* note 2, at 468.

[21] Jeffrey N. Gordon, *Pathways to Corporate Convergence? Two Steps on the Road to Shareholder Capitalism in Germany*, 5 COLUM J. EUR. L. 219, 219 (1999). *But see* Stephen M. Bainbridge, *Director v. Shareholder Primacy in the Convergence Debate*, 16 TRANSNAT'L LAW 45, 45 (2002) (challenging the assumption made in the convergence debate that the U.S. model is based on shareholder primacy, and arguing that the U.S. model is more accurately a director primacy model); Dan Puchniak, *The Japanization of American Corporate Governance? Evidence of the Never-Ending History for Corporate Law*, 9 ASIAN-PAC. L. & POL'Y J. 7, 11–12 (2007).

[22] Arthur R. Pinto, *Globalization and the Study of Comparative Corporate Governance*, 23 WIS. INT'L L.J. 477, 480 (2005).

[23] This Article grapples only with whether corporate governance convergence has occurred in a developing country, namely India; it does not address the debate regarding whether corporate governance reforms, and in particular the Anglo-American model of governance and a common law system, affect capital markets development. There is considerable empirical research that attempts to determine the legal systems, pre-conditions and legal reforms necessary for development of robust capital markets. Some of this research suggests that countries with stringent laws that protect investors with proper enforcement have enormous capital market benefits—their markets are larger and deeper, with firms having better access to external financing on better terms. *See, e.g.*, Doidge et al., *supra* note 4; La Porta et al., *Corporate Governance*, *supra* note 4, at 1161; La Porta et al., *Legal Determinants*, *supra* note 4, at 1138. Undoubtedly, there remains a vigorous debate about the complex relationship between good governance and economic growth. *See* Troy A. Paredes, *A Systems Approach to Corporate Governance Reform: Why Importing U.S. Corporate Law Isn't the Answer*, 45 WM. & MARY L. REV. 1055 (2004).

[24] For an overview of the convergence debate, see CONVERGENCE AND PERSISTENCE, *supra* note 1; Pinto, *supra* note 22; *see also* William W. Bratton & Joseph A. McCahery, *Comparative Corporate Governance and the Theory of the Firm: The Case Against Global Cross Reference*, 38 COLUM. J. TRANSNAT'L L. 213 (1999); Brian R. Cheffins, *Does Law*

differences between corporate governance structures of civil law and common law systems around the world.[25] These scholars argue that different corporate governance regimes have been competing for dominance. Therefore, much of the corporate governance convergence debate has revolved around which of the two different models of corporate forms, the shareholder-oriented/dispersed ownership model or the stakeholder-oriented/concentrated ownership model, has triumphed or will triumph.

Most convergence theory scholars advance the primacy of the Anglo-American model of governance, arguing that this model is the "endpoint of an evolutionary development" and is "both desirable and inevitable."[26] They contend that a global consensus of shareholder primacy is developing.[27] These scholars further suggest that convergence to the Anglo-American model will benefit countries and companies. They assert that, given globalization and the increased interdependence of financial markets around the world, some level of uniformity and convergence would promote the global competitiveness of firms.[28]

Matter? The Separation of Ownership and Control in the United Kingdom, 30 J. LEGAL STUD. 459 (2001); John C. Coffee Jr., *The Future as History: The Prospects for Global Convergence in Corporate Governance and its Implications*, 93 NW. U. L. REV. 641, 642 (1999); Ronald J. Gilson, *Globalizing Corporate Governance: Convergence of Form or Function*, 49 AM. J. COMP. L. 329, 336 (2001); Gustavo Visentini, *Compatibility and Competition Between European and American Corporate Governance: Which Model of Capitalism?*, 23 BROOK. J. INT'L L. 833 (1998).

[25] *See* Rafael La Porta et al., *Corporate Ownership Around the World*, 54 J. FIN. 471, 471–72 (1999); *see also* Lucian Arye Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, 52 STAN. L. REV. 127, 129 (1999); Amir N. Licht, *The Mother of All Path Dependencies: Toward a Cross-Cultural Theory of Corporate Governance Systems*, 26 DEL. J. CORP. L. 147, 149, 203 (2001).

[26] Coffee, *supra* note 24, at 705–07 ("Those firms seeking to grow in size to a global scale are likely to elect into the 'higher' governance standards already largely observed in the United States, and such bonding should minimize the social friction and even unrest that formal convergence could cause . . . ."); Hansmann & Kraakman, *supra* note 2, at 443 ("[W]e are witnessing rapid convergence on the standard shareholder-oriented model."). *See also* Brian R. Cheffins, *Current Trends in Corporate Governance: Going from London to Milan via Toronto*, 10 DUKE J. COMP. & INT'L L. 5, 6 (1999) ("Movement towards a worldwide capital market could in turn have a substantial impact on corporate governance in individual countries."); Lawrence A. Cunningham, *Commonalities and Prescriptions in the Vertical Dimension of Global Corporate Governance*, 84 CORNELL L. REV. 1133, 1145–46 (1999) ("[C]ountries have sought to improve their corporate governance structures by implementing the best policies from around the world."); Edward B. Rock, *America's Shifting Fascination with Comparative Corporate Governance*, 74 WASH U. L.Q. 367, 388 (1996) (championing competition among international corporate governance structures).

[27] *See* Cally Jordan, *The Conundrum of Corporate Governance*, 30 BROOK. J. INT'L L 983, 985–90 (2005).

[28] *See* Hansmann & Kraakman, *supra* note 2, at 450–51:

However, there are a number of opponents of the convergence theory. Some opponents argue that not only is there a lack of convergence toward a shareholder-oriented/dispersed ownership model, but that theories of convergence reflect U.S. economic imperialism.[29] Other opponents, most notably Professors Roe and Bebchuk, argue that such convergence is not possible because "path dependency" creates significant obstacles to convergence.[30] As Professor Coffee articulated, path dependence theory argues that "history matters, because it constrains the way in which institutions can change, and efficiency does not necessarily triumph."[31]

Professors Coffee and Gilson have made important contributions to the above debates. Instead of arguing that full convergence to the Anglo-American model has occurred or will occur, Professors Gilson and Coffee classify three different levels of convergence that have been observed under various legal regimes: functional convergence, formal convergence, and convergence by contract.[32] Functional convergence can occur when existing governance institutions are flexible enough to respond to the demands of changed circumstances without altering the institutions' formal characteristics.[33] Formal convergence, on the other hand, occurs when an effective response requires legislative action to alter the basic structure of existing governance institutions.[34] Convergence by contract may arise

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> The increasing internationalization of both product and financial markets has brought individual firms . . . into direct competition. It is now widely thought that firms organized and operated according to the shareholder-oriented model have had the upper hand . . . [and] can be expected to have important competitive advantages over firms adhering more closely to other models. These advantages include access to equity capital at lower cost (including, conspicuously, start-up capital), more aggressive development of new product markets, stronger incentives to reorganize along lines that are managerially coherent, and more rapid abandonment of inefficient investments.

[29] *See generally* Douglas M. Branson, *The Very Uncertain Prospect of "Global" Convergence in Corporate Governance*, 34 CORNELL INT'L L.J. 321, 330–36 (2001) (arguing that convergence is not taking place and that the world might be experiencing several backlashes against the prospect of a Lex Americana); Amir N. Licht, *Legal Plug-Ins: Cultural Distance, Cross-Listing, and Corporate Governance Reform*, 22 BERKELEY J. INT'L L. 195 (2004).

[30] *See* Bebchuk & Roe, *supra* note 25, at 135–36 (noting that forces exist to spur convergence but have been unable to overcome the historically developed, and differing, corporate governance structures); Curtis J. Milhaupt, *Property Rights in Firms*, 84 VA. L. REV. 1145, 1146, 1148 n. 11 (1998).

[31] *See* John C. Coffee, Jr., *The Rise of Dispersed Ownership*, 111 YALE L.J. 1, 4 (2001).

[32] *See* Coffee, *supra* note 24; Gilson, *supra* note 24.

[33] For discussions of "functional convergence," see THE ANATOMY OF CORPORATE LAW, *supra* note 2, at 4; Gilson, *supra* note 24.

[34] Gilson, *supra* note 24, at 336.

when existing governance institutions lack the flexibility to respond without formal change, and political barriers restrict the capacity for formal institutional change.[35]

More recently, some scholars have begun to recognize a middle ground between the two opposing sides of the convergence debate. These scholars argue that corporate governance models cannot be exported merely by changes in formal laws, and that recognizing the forces of the local culture is necessary for effective corporate governance.[36] According to Professor Pistor, "a simple convergence story does not do justice to the complexity of legal change."[37] However, that is not to state that formal legal changes are not occurring and are not important. These scholars differentiate between de facto and de jure convergence, i.e., between adoption of similar corporate governance laws and actual corporate governance practices.[38]

> Put simply, nations may formally adopt corporate governance systems that look like those elsewhere, but the acceptance of the enshrined principles may significantly lag their codification. This

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[35] Contractual convergence can occur through "corporate migration" and "securities market integration." *See* Coffee, *supra* note 24, at 653. Corporate migration occurs when a firm's securities are cross-listed on another country's securities exchange. For example, by listing on a U.S. securities exchange, foreign companies agree to comply with its corporate governance requirements, such as maintaining a minimum number of independent directors and an audit committee, as well as U.S. securities regulations that have corporate governance implications. *See* John C. Coffee Jr., *Racing Towards the Top?: The Impact of Cross-Listings and Stock Market Competition on International Corporate Governance,* 102 COLUM. L. REV. 1757 (2002). Some studies have found that this cross-listing generally leads to an increase in a firm's share price in significant part as a result of compliance by cross-listed companies with more rigorous disclosure and governance standards. *See* Mark H. Lang, Karl V. Lins & Darius P. Miller, *ADRs, Analysts and Accuracy: Does Cross Listing in the U.S. Improve a Firm's Information Environment and Increase Market Value?*, J. ACCOUNTING RESEARCH (forthcoming); Doidge et al., *supra* note 4. *But see* Kate Litvak, *Sarbanes-Oxley and the Cross-Listing Premium*, 105 MICH. L. REV. 1857 (2007) (arguing that the bonding premium for firms cross-listed in the United States declines with the adoption of Sarbanes-Oxley).

[36] *See generally* Bernard S. Black et al., *Final Report and Legal Reform Recommendations to the Ministry of Justice of the Republic of Korea*, 26 J. CORP. L. 546 (2001); Bernard S. Black, *The Legal and Institutional Preconditions for Strong Securities Markets*, 48 UCLA L. REV. 781 (2001); Bratton & McCahery, *supra* note 24; Paredes, *supra* note 23; Katharina Pistor et al., *Law and Finance in Transition Economies*, 8 ECON. OF TRANSITION 325 (2000).

[37] Katharina Pistor, *Patterns of Legal Change: Shareholder and Creditor Rights in Transition Economies* 46 (Eur. Bank for Reconstruction and Dev., Working Paper No. 49, 2002), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=214654.

[38] *See* Krishna Palepu, Tarun Khanna & Joseph Kogan, *Globalization and Similarities in Corporate Governance: A Cross-Country Analysis* 6 (Harvard NOM, Working Paper No. 02-31; Strategy Unit, Working Paper No. 02-041; Harvard Business School, Working Paper No. 02-041, 2002), *available at* http://ssrn.com/abstract=323621.

> may be for several reasons including a lack of understanding of what is implied by good corporate governance, absence of complementary institutions needed to implement the principles, or simply poor enforcement.[39]

These arguments are thus consistent with theories of path dependence in that they recognize the impact of local socioeconomic conditions, politics, and the legal system on corporate law.[40] These forces may prevent changes in the form of corporate law from effecting significant change in a country's overall governance scheme.

This new trend in the convergence debate better captures the reality of corporate governance convergence in action. While these studies have been ground-breaking, much of the world, and particularly the most recent wave of reforms, have yet to be fully studied. Surprisingly little attention has been paid to corporate governance reforms in recently emerging economies, particularly India.[41] This Article seeks to fill this gap by discussing whether corporate governance convergence has occurred or will occur in a developing economy such as India.

II. INDIA: AN OVERVIEW

India is, for a number of reasons, a particularly appropriate case study for examining convergence in a developing country. If full convergence to the Anglo-American model of corporate governance could occur in a developing economy, India would be the perfect testing ground. As a former British colony, Indian corporate law has historical ties to British corporate law. Moreover, after forty years of failed socialist policies, in the 1990s Indian leaders strongly advocated economic liberalization and a move toward an Anglo-American model of corporate law.[42]

The early 1990s was a period of extensive reform in India's economy and corporate legal regime. Not only were economic liberalization policies implemented, but new legal institutions were established to implement new rules in India's corporate and securities laws. These new regulatory institutions have been the primary avenue for producing new corporate

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[39] *Id.* at 5 (citations omitted).

[40] Katharina Pistor et al., *The Evolution of Corporate Law: A Cross-Country Comparison*, 23 U. PA. J. INT'L ECON. L. 791, 864 (2002).

[41] *See* Naomi Cahn, *Corporate Governance Divergence and Sub-Saharan Africa: Lessons from Out Here in the Fields*, 33 STETSON L. REV. 893, 898 (2004).

[42] *See* Ananya Mukherjee Reed, *Corporate Governance in India*, 37 J. BUS. ETHICS 249, 249 (2002); Diganta Mukherjee & Tejamoy Gosh, *An Analysis of Corporate Performance and Governance in India: Study of Some Selected Industries* 6 (Indian Statistical Inst., Delhi Planning Unit, Discussion Paper No. 04-19, 2004), *available at* http://www.isid.ac.in /~planning/workingpapers/dp04-19.pdf.

governance standards.[43]

This section briefly traces recent developments in India's economy and the resulting need for capital which has led to a growth in India's capital markets. It goes on to present an overview of India's corporate and securities laws, as well as the institutions responsible for drafting and implementing these laws, and considers how the roles of these institutions may affect the way in which corporate governance standards are enforced. Finally, this section discusses the traditional ownership structure of Indian firms. This section argues that the traditional ownership structure of Indian firms, as well as decades of socialist economic policies, help explain why corporate governance rules were largely undeveloped until the passage of Clause 49 in 2001.

A. India's Economic and Stock Market Growth

1. Economic Growth and the Need to Attract Capital

India gained its independence from British rule in 1947 and has since become the world's largest democracy. More recently, particularly in the past decade, India has been hailed as an "emerging giant," due to its economic growth, with some analysts going so far as to predict that between 2015 and 2050 India's GDP growth rate "would exceed that of all other major countries in the world, including China."[44]

Despite recent economic growth, India's economy has not followed a smooth growth path since independence.[45] During much of the post-independence period, India's economy was saddled with socialist policies that led to the slow growth rate often called the "Hindu rate of growth."[46] India's post-independence leaders attempted to insulate the country from economic shocks through state control and intervention. Their economic development strategy was inward-looking and included centralized planning, complex industrial licensing requirements, nationalization of banks, substantial public ownership of heavy industry, high tariff barriers, tight restriction on the operations of foreign firms and on imports and exports, and high bureaucratic control.[47]

Significant economic reforms in India since the early 1990s have led to

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[43] John Armour & Priya Lele, *Law, Finance, and Politics: The Case of India* 2 (ECGI—Law, Working Paper No. 107/2008, 2008), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1116608.

[44] *See* PANAGARIYA, *supra* note 10, at xv. For a comprehensive chronicle of the history of economic policy in India since independence in 1947, see *id.*

[45] JOS MOOIJ, THE POLITICS OF ECONOMIC REFORMS IN INDIA 19 (2005).

[46] *See* PANAGARIYA, *supra* note 10, at 16.

[47] *See id.* at xvii, 47–77.

a transformation of the Indian economy.[48] Following a balance of payments crisis that came to a head in 1991, Dr. Manmohan Singh—the Finance Minister in the early 1990s and India's current Prime Minister—guided the government through a process of systematic economic reforms, marking a radical departure from over forty years of socialist-inspired government planning.[49] Such reforms were continued by other administrations in the 1990s, furthering economic liberalization by opening the economy to foreign and direct competition and introducing significant privatization of various public sector enterprises.[50]

The results of these economic reforms have been impressive. The growth of India's GDP has averaged about six percent since 1991 and around eight percent in the past three to four years, making India, along with China, one of the fastest growing countries in the world.[51] The Indian economy is now "characterized by an acceleration of growth in GDP, foreign trade, and foreign investment."[52]

Economic growth and the accompanying need for capital have led to large changes in the business of Indian companies. For example, since 2000, Indian companies, particularly those in the pharmaceutical and computer services industries, have been on an acquisition spree abroad.[53] More importantly, the largest Indian companies are striving to be global corporate actors and have sought access to global capital markets. In the first half of 2006 Indian companies accounted for almost a third of new issuances of depositary receipts globally.[54]

Some Indian firms have attempted to access capital by listing abroad. However, despite the initial push toward foreign listing, relatively few Indian companies have listed in the United States or the United Kingdom.

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[48] In the 1980s, the government made some tentative moves towards economic liberalization, although most of the government's reform policies were piecemeal and uncoordinated. *See* PANAGARIYA, *supra* note 10, at 78–94.

[49] See PANAGARIYA, *supra* note 10, at 100–03.

[50] *See* MOOIJ, *supra* note 45, at 19–22.

[51] *See* PANAGARIYA, *supra* note 10, at 259; *see also India on Fire*, ECONOMIST, Feb. 3, 2007. While this growth has been impressive, there is concern that India's economy may be "overheating" and that such growth cannot be sustained without major reforms and investment by the government in the public sector. *Id. See also India Overheats*, ECONOMIST, Feb. 3, 2007.

[52] PANAGARIYA, *supra* note 10, at 108.

[53] In the first quarter of 2007, Indian firms announced 34 acquisitions of non-Indian firms worth more than $10.7 billion, and in 2006, such acquisitions totaled $23 billion. *Marauding Maharajas*, ECONOMIST, Mar. 31, 2007 ("With GDP growth averaging 8% . . . Indian firms have been minting money in the past three years. Their average profit margins are around 10% . . . . 60% of India's 200 leading companies are looking to invest this loot in foreign purchases.").

[54] *See* Rajesh Chakrabarti, William Megginson & Pradeep K. Yadav, *Corporate Governance in India*, 20 J. APPLIED CORP. FIN. 59 (2008).

While thousands of companies are listed on the Indian stock exchanges, only about fifty Indian firms have listed in the United Kingdom.[55] Similarly, Indian companies are still in the early stages of experimenting with U.S. capital markets. The process of listing in the U.S. began with Infosys, a leading Indian technology company, listing on the National Association of Securities Dealers Automated Quotations (NASDAQ) in the United States in 1998 and was followed by the listing of other Indian companies, most in the technology sector.[56] While thousands of companies are listed on the Indian stock exchanges, only a handful of those companies trade in the United States as ADRs;[57] only twelve are listed on the New York Stock Exchange (NYSE)[58] and three on NASDAQ.[59]

After some of corporate India's successful listings abroad, Indian regulators and leading companies argued that good corporate governance and internationally accepted standards of accounting and disclosure could help them access capital, particularly foreign capital. The desire to raise capital has been cited as a leading driver of the support for corporate governance reforms by India's corporate leaders.[60] In fact, "firms appear to have been motivated in large part by the desire to gain greater access to capital, and especially to foreign institutional investment."[61]

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[55] *See* Press Release, London Stock Exchange, Four Indian Firms Take AIM in Four Weeks (June 10, 2008), *available at* http://www.londonstockexchange.com/NR/exeres/ADC0E3E6-3EE3-45DA-91E9-B7D58C2F5CE9.htm; *see also* Press Release, London Stock Exchange, London Stock Exchange Markets Opened by Indian Finance Minister (Feb. 4, 2005), *available at* http://www.londonstockexchange.com/en-gb/about/Newsroom/pressreleases/2005/040205india.htm (stating that "India is one of the [London] Exchange's three key priority markets for attracting international listings alongside China and Russia.").

[56] Infosys has been at the forefront of India's rapidly expanding information technology (IT) industry. Revenues from the IT industry constitute approximately 5.4% of India's gross domestic product and have grown at the rate of almost 30% since 1997. *Gravity's Pull,* ECONOMIST, Dec. 15, 2007.

[57] American Depositary Receipts (ADRs) are securities a non-U.S. company that seeks to list on a U.S. stock exchange offers. An ADR is essentially a receipt that is issued by a U.S. depositary bank and is backed by the company's shares which are held by the bank. Because ADRs are quoted in U.S. dollars and trade just like any other stock, they make it simple for investors to diversify their holdings internationally. *See* NYSE—Glossary, http://www.nyse.com/glossary/Glossary.html (last visited Jan. 30, 2009).

[58] Ruth David, *NYSE Buys into India*, FORBES, Jan. 10, 2007, http://www.forbes.com/2007/01/10/india-nyse-goldman-markets-emerge-cx_rd_0110markets01.html.

[59] *Nasdaq Looks at Indian Mid-Cap Cos' Listing*, HINDU BUS. LINE, Feb. 7, 2004, *available at* http://www.blonnet.com/2004/02/08/stories/2004020801500300.htm.

[60] Balan N. Balasubramanian, Vikramaditya S. Khanna & Bernard S. Black, *Firm-level Corporate Governance: A Case Study of India*, at 5 (U. of Tex. Law, Law and Econ. Research Paper No. 87, 2007), *available at* http://ssrn.com/abstract=995650.

[61] Dhammika Dharmapala & Vikramaditya S. Khanna, *Corporate Governance, Enforcement, and Firm Value: Evidence from India* 31 (Univ. of Mich. Law Sch., Olin Working Paper No. 08-005, 2007), *available at* http://ssrn.com/abstract=1105732.

This need for capital may explain the leading role of large corporations and industry groups in pushing for tough new corporate governance standards.[62] Large corporations in India have been instrumental in leading the path toward formal corporate governance changes in India. They have argued that sustaining India's economic growth requires attracting portfolio investors, including Western institutional investors.[63] For example, in public statements and speeches, leaders of Infosys, a major player in the corporate governance campaign both inside and outside of India, have repeatedly pushed for governance reforms in India, arguing that such reforms will attract foreign investors and allow Indian companies to raise capital.[64]

2. India's Rapidly Growing Stock Markets

Capital markets are not new to India. The Mumbai Stock Exchange (BSE) was established in 1875 and is the oldest stock exchange in Asia.[65] "At the beginning of the twentieth century, India had four functioning stock exchanges . . . with well defined rules governing listing, trading and settlement rules" and by 1947 over 800 companies were listed and trading on Indian exchanges.[66] According to some commentators, in 1947 India inherited what was, at least formally, the best financial market in the developing world.[67]

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[62] *Id.* Dharmapala and Khanna do not find evidence that the Clause 49 reforms caused an increase in foreign institutional investment. *Id.* at 30.

[63] *See id.* at 31. At least in India, foreign and institutional investors have generally demanded great disclosure and a more rigorous, clear, and recognizable governance regime. *See* NATIONAL FOUNDATION FOR CORPORATE GOVERNANCE, CORPORATE GOVERNANCE IN INDIA: THEORY AND PRACTICE 7 (Sept. 2004) [hereinafter NATIONAL FOUNDATION]; LALITA SOM, STOCK MARKET CAPITALIZATION AND CORPORATE GOVERNANCE 29 (2006).

[64] Infosys touts as its mission: "To achieve our objectives in an environment of fairness, honesty and courtesy towards our clients, employees, vendors and society at large." Infosys—About Infosys/Who We Are, http://www.infosys.com/about/who-we-are/default.asp (last visited Jan. 30, 2009). Since its inception, Infosys has won a number of awards for its corporate governance practices. *See* Infosys—About Infosys/Awards, http://www.infosys.com/about/awards/default.asp (last visited Jan. 30, 2009). Furthermore, "Infosys pays its directors one of the highest annual retainers in India—nearly $45,000 a year." *Is Indian Business Ready for a Brave New World of Tough Corporate Governance?*, KNOWLEDGE@WHARTON Dec. 22, 2005, http://www.whartonsp.com/articles/article.asp?p=433384&seqNum=3. Its board has directors from around the world, such as Jeffrey Lehman, former president of Cornell University and a well-respected legal academic. *See* Infosys—Management Profiles, http://www.infosys.com/newsroom/journalist-resources/management-profiles.asp (last visited Jan. 30, 2009). Of course, corporate governance standards at Infosys are not the norm in India.

[65] *See* SOM, *supra* note 63, at 6.

[66] *See id.*

[67] *How Some Firms in India Succeed by Bypassing Entrenched Financial and Legal Systems*, KNOWLEDGE@WHARTON Nov. 1, 2006, http://knowledge.wharton.upenn.edu

While India in 1947 had "reasonably functioning stock markets and a fairly well developed (if not extensive) banking system, [as well as] . . . a nascent but vibrant equity culture among a section of the urban populace," the view of many is that "India squandered its early advantages" through its post-independence regulatory regime.[68] Post-independence and prior to economic liberalization, India's capital markets remained largely underdeveloped. During this period, India's capital markets were characterized by significant government interference but little regulatory oversight of trading activity.[69]

Along with India's rapid economic growth, India's capital markets—particularly its equity markets—have vastly expanded.[70] The BSE and the National Stock Exchange (NSE), the country's two leading exchanges, have thousands of listed companies, rivaling the world's largest securities market—the United States.[71] As of September 2007, there were approximately 4800 companies listed on the BSE and approximately 1200 on the NSE.[72] Despite the large numbers of listed companies, the market capitalization and trading volume of these exchanges were dominated by the top companies.[73] Trading on India's markets has become increasingly active. According to a recent study, "in both 2005 and 2006, the number of

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/article.cfm?articleid=1596&CFID=3677137&CFTOKEN=82911816.

[68] Omkar Goswami, *Getting There—Pretty Rapidly: The State of Corporate Governance in India*, *in* A COMPARATIVE ANALYSIS OF CORPORATE GOVERNANCE IN SOUTH ASIA 130 (Farooq Sobhan & Wendy Werner, eds., 2003) *available at* http://www.bei-bd.org/docs/cg1.pdf.

[69] *See* PANAGARIYA, *supra* note 10, at 242.

[70] Armour & Lele, *supra* note 43, at 10. While India's equity markets are highly developed, "relative to similarly situated developing countries," its debt markets, particularly "markets for publicly-traded corporate debt (bonds) are virtually non-existent." *Id. See also* PANAGARIYA, *supra* note 10, at xxv.

[71] *See* Armour & Lele, *supra* note 43, at 7. There are also twenty regional exchanges, but the BSE and NSE comprise the bulk of the trading volumes on Indian exchanges. The BSE is the oldest stock exchange in Asia, and dominated Indian stock markets until 1994 when SEBI established the NSE. *See* SOM, *supra* note 63, at 5–8.

[72] *See* Chakrabarti et al., *supra* note 54, at 60. In comparison, as of December 31, 2007, NYSE, the worlds' largest cash equities exchange, had a total of 2805 issuers, including operating companies as well as various funds. NYSE Group—Number of Issuers (2003–present), http://www.nyxdata.com/nysedata/Default.aspx?tabid=115 (follow "Listed Companies" hyperlink; then follow "NYSE Group—Number of Issuers (2003–present)" hyperlink) (last visited Jan. 30, 2009). The NASDAQ has approximately 3200 listed companies. NASDAQ, NASDAQ Global Platform, March 2007, http://www.nasdaq.com/reference/NASDAQ%20Global%20Platform%20-%20Fact%20Sheet.pdf (last visited Jan. 30, 2009).

[73] Many of the companies on the BSE have low market capitalization with little or no trading in their stock. The preponderance of low-capitalized companies on India's stock exchanges is often identified as a "fundamental structural flaw in India's capital markets . . . [that encourages] stock price manipulation and insider trading, and overburdens the current regulatory system." SOM, *supra* note 63, at 3.

trades on the NSE was the third highest in the world, just behind NASDAQ and the NYSE, and several times the number of trades on the LSE or Euronext."[74] This rapid expansion of the capital markets was accompanied by significant regulatory changes.

B. Regulation of Public Companies in India

In order to understand the process and implications of recent regulatory changes in India's corporate governance regime, it is important to have a general overview of India's legal tradition and its current regulation of public companies. This section begins by presenting an overview of India's legal tradition, and follows by outlining the basic corporate law and regulatory framework applicable to public companies in India. It also addresses the role of the government institutions responsible for developing and enforcing Indian corporate law, as well as the role of the judiciary in advancing corporate law.

1. Overview of Indian Corporate Law

a. India's Legal Tradition

As a former British colony, India is generally viewed as a common law country with an Anglo-American legal tradition.[75] Indian corporate law derives from the Joint Stock Companies Act, 1850, which was modeled on the English Joint Stock Companies Act, 1844.[76] Indian corporate law continued to emulate English law even after India achieved independence in 1947.[77] The Bhabha Committee, whose recommendations ultimately formed the basis for the Companies Act, 1956,[78] was convened partly in response to the report of the United Kingdom's Cohen Committee, which recommended far-reaching changes to the English Companies Act, 1929.[79]

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[74] *See* Chakrabarti et al., *supra* note 54, at 60.

[75] *See* Andreas Buss, *Dual Legal Systems and the Basic Structure Doctrine of Constitutions: The Case of India*, 19 CAN. J.L. & SOC'Y 23, 26-27 (2004). The Indian constitution reflects significant American influence. When the framers of the Indian constitution initially gathered in 1946, an important aspect of their approach to drafting involved a careful study of the Constitution of the United States, with respect to both the spirit of compromise the document reflects, as well as many of the substantive provisions. *See* Vijayashri Sripati, *Toward Fifty Years of Constitutionalism and Fundamental Rights in India: Looking Back to See Ahead (1950-2000)*, 14 AM. U. INT'L L. REV. 413, 421 (1998).

[76] P.M. Vasudev, Capital Stock, Its Shares and Their Holders: A Comparison of India and Delaware (Mar. 2007) (unnumbered working paper), *available at* http://ssrn.com /abstract=913282.

[77] *Id.*

[78] The Companies Act, 1956, Acts of Parliament, 1956, *available at* http://indiacode.nic.in/fullact1.asp?tfnm=195601.

[79] Government of India, Ministry of Finance, Report of the Companies Act Amendment

Further, the Companies Act drew inspiration from the English model with regard to much more than simple timing. The influence of English company law on the Indian Companies Act, 1956, was so prevalent that one Indian committee, convened the following year to assess the success of the new Companies Act and recommend any necessary amendments, saw fit to specifically justify the ways in which they had deviated from the British model.[80]

Despite India's common law tradition, "many of its laws were in fact codified during British rule. This was then overlaid with further legislation when, in post-independence India, the government implemented a socialist reform agenda in encompassing all areas of commercial activity, including corporate finance."[81] From 1947 to 1991, the government's policies included heavy regulation of public companies; including significant government involvement in public equity offerings that lead to legal measures that "established a tightly-controlled regime covering almost all aspects of corporate management."[82] Thus, much of the post-liberalization period involved dismantling or amending the socialist codification process, and establishing new institutions, such as SEBI, to oversee increasingly privatized capital markets.[83]

b. The Companies Act of 1956

The Companies Act, as codified in 1956 and amended thereafter, provides the general legal framework for companies in India, governing the incorporation, functioning, and winding up of Indian companies. All registered companies in India, whether public or private, are governed by

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Committee, 1957, at 2.

[80] *Id.* at 6.

[81] Armour & Lele, *supra* note 43, at 14. For an overview of the pre-liberalization corporate and securities laws, *see id.* at 15. This pre-liberalization period is often referred to as the period of the "License Raj" because it was characterized by requirements of government permission to engage in all sorts of standard business activities, resulting in a highly restrictive corporate environment in which political and family connections became increasingly important for obtaining the necessary permits to conduct corporate activities. *See* Tania Mazumdar, *Where the Traditional and Modern Collide: Indian Corporate Governance Law*, 16 TUL. J. INT'L & COMP. L. 243, 246 (2007).

[82] Armour & Lele, *supra* note 43, at 15. For example, prior to 1992, the Capital Issues (Control) Act, 1947 (CICA), required the permission of the central government for the issuance of capital, and gave the government authority to control pricing of new issues of equity. *Id.* at 18. Also, in line with the government's socialist agenda, the state "became the principal provider of both debt and equity capital for private firms." Balasubramanian et al., *supra* note 60, at 5.

[83] For example, as part of the relaxation of central government control over corporate affairs, the CICA was repealed in its entirety in 1992. *See* Capital Issues (Control) Bill, No. 106-C of 1992.

the Companies Act.[84] Voluminous and containing hundreds of sections, the Companies Act draws heavily from the U.K. Companies Act of 1948.[85]

The regulatory framework governing corporate boards is set forth in Sections 252 to 269 of the Companies Act. The corporate governance principles in the Companies Act, particularly with respect to listed companies, are limited. For example, similar to the corporate law of most U.S. states, the Companies Act does not address specific corporate governance measures such as composition and independence of a company's directors, or the minimum qualifications required to become a director, though it does include some provisions dealing with management and administration of companies.[86]

Similarly, the Companies Act of 1956 offers little in the way of investor protection, focusing primarily on cases of oppression and mismanagement. As discussed in Part II.B.4 below, these provisions have provided little protection to shareholders. There is also minimal focus on transparency or disclosure. For example, Indian companies whose shares are not traded on any Indian stock exchange are not required to prepare or distribute quarterly and interim reports to shareholders.

In recent years, there have been a number of attempts by the Ministry of Company Affairs (MCA) (previously the Department of Company Affairs within the Ministry of Finance) to amend the Companies Act to improve corporate governance and to modernize India's company law. However, the major amendments to the Act are still pending.[87] Overall, as described in Part III.A.2 below, the government thus far has been unable to amend the Companies Act to incorporate the corporate governance principles adopted in Clause 49.

2. *The Stock Exchanges and the Listing Agreement*

As discussed above, India has two national stock exchanges—the BSE and the NSE. Companies seeking to list on either exchange are required to comport with the requirements of the respective exchange's Listing Agreement. The stock exchanges are Self Regulatory Organizations (SROs) that are registered with and regulated by SEBI. The SEBI Act of

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[84] Similar to the legal framework governing public companies in the United States, public companies listed on one of the Indian national exchanges must comply with the rules and regulations prescribed by SEBI and the listing agreements of the stock exchange on which they are listed, as well as other laws.

[85] *See* Priya Lele & Mathias Siems, *Diversity in Shareholder Protection in Common Law Countries*, 5 J. INST'L COMPARISONS 3 (2007), *available at* http://ssrn.com/abstract=988409.

[86] *See* Sumant Batra, *India: An Overview of Corporate Governance of Non-Listed Companies*, *in* CORPORATE GOVERNANCE OF NON-LISTED COMPANIES IN EMERGING MARKETS 167, 169 (OECD Publishing 2006).

[87] *Id.* at 168–69.

1992 grants SEBI the authority to regulate the stock exchanges, including the power to conduct inspection of the stock exchanges.[88]

The Listing Agreement defines the rules and processes that companies must follow in order to remain listed companies on an Indian stock exchange. This agreement stipulates many actions that listed companies must take, from payment of listing fees to observance of various corporate governance standards.[89] Some specific examples include periodic disclosures of financial statements, observance of requirements concerning independent directors, and compliance with any additional rules and regulations that may be put forth by SEBI or other government agencies.[90] The Listing Departments of the exchanges monitor compliance with the provisions of the listing agreements, and can impose disciplinary measures in the event of noncompliance, up to and including delisting.[91]

Instead of legislative changes, the primary corporate governance reforms in India have been instituted through changes to the Listing Agreement. As described in Part III.A.2 below, Clause 49 was instituted through changes to the Listing Agreement, in part because of the flexibility that SEBI has had in amending the Listing Agreement.

3. The Regulators: SEBI and the MCA

Public companies in India face a fragmented regulatory structure. The Companies Act is administered by the MCA and is currently enforced by the Company Law Board (CLB). The MCA, SEBI, and the stock exchanges share jurisdiction over listed companies, with the MCA being the primary government body charged with administering the Companies Act of 1956, while SEBI has served as the securities market regulator since 1992.[92]

In connection with India's economic liberalization and the move toward further development of India's capital markets, the central government established regulatory control over the stock markets through the formation of the SEBI.[93] SEBI, which was originally established in 1988 as an advisory body, was granted authority to regulate the securities

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[88] The Securities and Exchange Board of India Act, 1992, No. 15, Acts of Parliament, 1992, *available at* http://indiacode.nic.in/fullact1.asp?tfnm=199215.

[89] BSE, Guidelines for Listing, http://www.bseindia.com/about/abintrobse/listsec.asp (last visited Jan. 30, 2009).

[90] *Id.*

[91] *Id.*

[92] Ministry of Corporate Affairs, Government of India, About MCA, http://www.mca.gov.in/MinistryWebsite/dca/aboutus/aboutus.html (last visited Jan. 30, 2009).

[93] *See* The Securities and Exchange Board of India Act, 1992, *supra* note 88; *see also* Armour & Lele, *supra* note 43, at 18.

market under the Securities and Exchange Board of India Act of 1992 (SEBI Act).[94] Through the passage of this Act, Parliament established SEBI as an independent statutory authority, but required it to submit annual reports to the legislature.

SEBI was envisioned to serve as a "market oriented independent entity to regulate the securities market" akin to the role of the Securities and Exchange Commission (SEC) in the United States.[95] In fact, the stated purpose of the agency is "to protect the interests of investors in securities and to promote the development of, and to regulate, the securities market."[96]

The realm of SEBI's statutory authority has long been the subject of heated debate. Some have argued that "it may be stated that the SEBI Act of 1992 was mostly a list of responsibilities of the regulator and was devoid of reasonable statutory backing for discharging the responsibilities."[97] The primary tasks with which SEBI has been charged include "regulating the business in stock exchanges and any other securities markets . . . prohibiting fraudulent and unfair trade practices relating to securities markets . . . prohibiting insider trading in securities . . . [and] regulating substantial acquisition of shares and take-over of companies . . . ."[98] However, SEBI's authority for carrying out these tasks has not always been clear. For example, when Indian financial markets experienced massive share price rigging frauds in the early 1990s, SEBI was found not to have sufficient statutory power to carry out a full investigation of the frauds.[99] Accordingly, the SEBI Act was amended in order to grant it sufficient powers with respect to inspection, investigation, and enforcement, in line with the powers granted to the SEC in the United States.[100]

One of the most contentious aspects of SEBI's power is its rulemaking authority. As mentioned, SEBI has made significant amendments to the Listing Agreement to greatly increase the responsibilities of listed companies. However, some have disputed that SEBI was ever granted the authority to impose additional governance rules in this fashion. In the United States, for example, the SEC can point to the Sarbanes-Oxley Act as specifically conferring upon it the authority to prescribe rules to implement

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[94] *Id.* The SEBI Act of 1992 has since been amended three times: in 1995, 1999, and 2002. *See* Asian Corporate Governance Association, http://www.acga-asia.org/public/files /Kania_rep_032005.pdf.

[95] *See* Armour & Lele, *supra* note 43, at 18.

[96] The Securities and Exchange Board of India Act, 1992, *supra* note 88.

[97] Suchismita Bose, *Securities Markets Regulations*, 1 ICRA BULLETIN: MONEY & FINANCE 83, 106, *available at* http://ssrn.com/abstract=1140107 (2005).

[98] The Securities and Exchange Board of India Act, 1992, *supra* note 88.

[99] Bose, *supra* note 97, at 87.

[100] *Id.* at 106.

the legislation.[101] SEBI, on the other hand, cannot point to a similar piece of legislation to support imposition of the same requirements on Indian companies through Clause 49. Instead, SEBI must look to the basics of its own purpose, as given in the SEBI Act. Under Section 11A of the SEBI Act, authority is granted to "specify, by regulations, the matters relating to issue of capital, transfer of securities and other matters incidental thereto . . . and the manner in which such matters shall be disclosed by the companies."[102] In addition, SEBI is granted broad authority to "specify the requirements for listing and transfer of securities and other matters incidental thereto."[103] SEBI's exercise of this broad authority has led to strife with the MCA.

Since SEBI's creation in 1992, tensions have arisen between SEBI and the MCA. The conflicts between SEBI and the MCA stem in part from the reality that many of the regulatory responsibilities created by the various pieces of relevant legislation are exercised concurrently by multiple regulatory agencies. This overlap results from the charges of the agencies themselves, as well as from issues such as the expansion of SEBI's powers.[104] Under the Companies Act, MCA is responsible for regulating all registered companies.[105] However, under the SEBI Act, all listed companies fall under the authority of SEBI as well.[106] It should be noted that SEBI itself disputes the existence of any regulatory overlap.[107] However, this assessment stands at odds with the record of disagreement between the two agencies concerning the respective responsibilities of each regulatory body. As will be seen in Part III.A.2, these long-standing conflicts between SEBI and the MCA spilled over into India's corporate

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[101] Sarbanes-Oxley Act of 2002 (SOX), Pub. L. No. 107-204, § 301, 116 Stat. 745, (codified as amended in scattered sections of chapters 11, 15, 18, 28 & 29 of U.S.C.).

[102] The Securities and Exchange Board of India Act, 1992, *supra* note 88.

[103] *Id.* The SEC, by contrast, is not granted such sweeping authority by Section 4 of the Securities Exchange Act of 1934, which created the SEC. *See* Securities Exchange Act of 1934 § 4, 15 U.S.C.A. § 78a (2008).

[104] The MCA strongly resisted SEBI's requests for additional power. Richa Mishra and K.R. Srivats, *SEBI Seeks More Powers Under Companies Act*, HINDU BUS. LINE, Dec. 15, 2003, *available at* http://www.blonnet.com/2003/12/16/stories/2003121601760400.htm (noting existence of turf war and SEBI's attempts to expand its powers); *SEBI Act to Be Amended*, HINDU BUS. LINE, June 1, 2002, *available at* http://www.thehindu businessline.com/2002/06/02/stories/2002060201200200.htm; Shaji Vikraman & Hema Ramakrishnan, *Safeguards Likely in SEBI's Search and Seizure Powers*, HINDU BUS. LINE, May 2, 2002, *available at* http://www.thehindubusinessline.com/2002/05/02/stories /2002050201500100.htm (noting DCA's opposition and existence of a "turf war").

[105] *Govt. to Form A Panel to Reduce SEBI, DCA Overlap*, INDLAW NEWS, June 2, 2003, *available at* http://news.indlaw.com/1D0D72FA584A040D8FDFB8FAF8315665.

[106] *Id.*

[107] Richa Mishra, *No Overlap Between SEBI, DCA: Bajpai*, HINDU BUS. LINE, Sep. 12, 2003, *available at* http://www.thehindubusinessline.com/2003/09/12/stories/200309120243 0500.htm.

governance reform process.

4. The Role of the Judiciary in Development of Corporate Law

As in the Anglo-American system, the Indian legal framework allows for a significant role for the judiciary.[108] For example, the primary corporate governance measures under the Companies Act are the statutory provisions protecting shareholders against "oppression"[109] and "mismanagement."[110] Shareholders can bring suit against a company's management or board of directors in cases of oppression and mismanagement, in order to protect shareholder interests.

While Indian courts have developed extensive case law interpreting and applying the provisions of the Companies Act, these judicial judgments have not radically altered the state of corporate governance in India as Clause 49 has.[111] In fact, some even argue that the lack of judicial action has meant that "India seems to have moved away from the common law tradition of changing the law on a case-by-case basis and toward the tradition of detailed rule-making backed by public enforcement mechanisms, which is usually associated with the civil law countries."[112]

The primary reason behind the lack of development of corporate governance standards through the judiciary is the failure of the Indian judicial system to effectively resolve corporate disputes. India's judicial process has long been the subject of criticism. According to a vocal critic of the Indian legal system, the judicial process involves countless delays, and when decisions are finally rendered by courts, they are often ignored.[113] "The defining feature of the Indian court system is the staggering delays involved in resolving a case by trial, which typically would take up to 20 years."[114] Given the significant delays in bringing a suit, there is little incentive for shareholders to advocate for their rights through the courts.

According to a recent report by the World Bank, the process under

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[108] *See* Sripati, *supra* note 75, at 423–24, 439. For example, the Indian Constitution contains an explicit grant of the power of judicial review to the Supreme Court, applicable to any law or order that it felt to be in violation of any fundamental right. *See* INDIA CONST. art. 32.

[109] "Oppression" refers to conducting of the affairs of a company in a manner prejudicial to public interest or interests of the company or the shareholders or in a manner oppressive to any members. The Companies Act, 1956, *supra* note 78, § 397.

[110] "Mismanagement" occurs when the affairs of a company are conducted in a manner prejudicial to the interests of the company or to the public interest. The Companies Act, 1956, *supra* note 78, § 398.

[111] Armour & Lele, *supra* note 43, at 31.

[112] Lele & Siems, *supra* note 85, at 5.

[113] *See* ARUN SHOURIE, COURTS AND THEIR JUDGMENTS: PREMISES, PREREQUISITES, CONSEQUENCES (Rupa & Co. 2001).

[114] Armour & Lele, *supra* note 43, at 28.

which cases brought pursuant to the Companies Act were adjudicated was similarly mired in delay and ineffectiveness. For example the Company Law Board (CLB), the primary judicial authority for enforcement of the Companies Act, experienced significant delays and a large backlog of cases.[115] The delays at the CLB level were further compounded by the ability of parties to appeal CLB decisions to the high courts and Supreme Court. As of October 2001 the vast majority of rulings had been appealed, and over twenty million cases awaited final judgment in the various Indian courts.[116]

In order to ameliorate this backlog of cases and to consolidate various duties previously allocated to several different government bodies, the Indian Parliament amended the judicial structure with respect to corporate law matters in 2002. The Companies (Second Amendment) Act, 2002 (2002 Act), created a new National Company Law Tribunal (NCLT), along with its appellate body, the National Company Law Appellate Tribunal (NCLAT), to enforce the provisions of the Companies Act.[117] The NCLT was also granted jurisdiction with respect to matters previously distributed between several different government agencies, including management of "sick industrial companies" and the dismantling of unprofitable companies, a power that previously rested with the various Indian high courts.[118]

[115] In the period from 1997 to 2001, nearly 170,000 cases were brought to the CLB. At the end of 2001, 11,000 of these cases were still pending—and this number was actually down from nearly 20,000 cases still pending at the end of 1999. WORLD BANK & INT'L MONETARY FUND, REPORT ON THE OBSERVANCE OF STANDARDS AND CODES, at 21 (2004), *available at* http://www.worldbank.org/ifa/rosc_cg_ind.pdf [hereinafter WORLD BANK REPORT].

[116] Varun Bhat, *Corporate Governance in India: Past, Present, and Suggestions for the Future*, 92 IOWA L. REV. 1429, 1448–49 (2007). The delays resulting from this backlog of cases have been severe—petitioners are occasionally made to wait as long as six years for a preliminary hearing, and as long as twenty years for a final judgment. *Id.*

[117] The Companies (Second Amendment) Act, 2002, No. 11, Acts of Parliament, 2003.

[118] *Id.* India's insolvency system has had a history of problems. According to a recent World Bank study, the process of liquidating a company takes as long as twelve years in India, and provides a return of only sixteen cents per dollar invested. *No Easy Cure for Industrial Sickness*, ECONOMIC TIMES (India), Jan. 2, 2008, *available at* http://economictimes.indiatimes.com/News/Economy/Policy/No_easy_cure_for_industrial_sickness/rssarticleshow/2667172.cms. One of the purposes of the NCLT is to ameliorate problems in the insolvency process. The NCLT is responsible for the "revival and rehabilitation of sick industrial companies," i.e. an industrial company that has either accumulated losses equaling fifty percent or greater of the company's average net worth over the preceding four years, or has failed to repay its debts for three consecutive quarters despite written demand for repayment by the company's creditors. *Id.* Once the NCLT has determined that a company is a "sick industrial company," it may set a timeline for the company to reestablish a net worth in excess of its accumulated losses, or repay its outstanding debts. If such action is not feasible, the NCLT may order the financial reconstruction of the company, change or takeover of management, merger or sale of the company, or other measures "as may be necessary or expedient." The authority given to the NCLT in this area is broad and

With respect to enforcing the Companies Act, the NCLT's powers are largely the same as those of the CLB; in fact, many of the amendments given effect by the 2002 Act literally serve only to replace the term "Company Law Board" with the term "Tribunal." Among its other powers, the NCLT has the authority to provide relief in cases of oppression and mismanagement, remove management, direct a special audit, inspect the company's accounts, and impose fines for certain violations of the Companies Act.[119] However, recent data indicate that these abilities are seldom used.[120]

One of the most significant changes of the 2002 Act is to provide for a separate appellate body specifically convened to hear appeals from the rulings of the NCLT. The purpose of this amendment was in part to lift a burden from the various high courts. Given the mutually compounding problems that arise when a grossly understaffed judiciary is asked to handle a massive caseload, it becomes readily apparent why a separate Company Law Tribunal with its own counterpart appellate body was needed.[121] Although the rulings of the Appellate Tribunal are still appealable to the Supreme Court of India under the new enforcement scheme,[122] the availability of a separate appellate body specifically tasked with handling appeals from the NCLT's rulings was intended to prevent the tremendous logjam of proceedings previously seen in the various high courts. However, as discussed in Part IV.I.3 below, despite efforts to allow for enforcement

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sweeping, and even extends to mandating that a company be liquidated and wound up if it determines that the situation of the company is such that it is not likely to become viable at any point in the reasonably foreseeable future. These additional powers dealing with the restructure and winding up of companies that are failing to turn a profit are designed to help shore up a substantial weakness under the old regulatory scheme, and represent an important step in dealing with the difficulties presented by insolvency. *Id.* Prior to the establishment of the NCLT, the responsibility for managing "sick industrial companies" was assigned to the Board for Industrial and Financial Reconstruction (BIFR). This body was created by the Sick Industrial Companies (Special Provisions) Act, 1985 (SICA), and was entrusted by that Act with many of the same powers of investigation and winding up of corporate entities designated as sick industrial companies. *See* Sick Industrial Companies (Special Provisions) Act, 1985, No. 1, Acts of Parliament, 1986. The BIFR and its related appellate board were dissolved by the Sick Industrial Companies (Special Provisions) Repeal Act, 2003. This Act was passed on Jan. 1, 2004, and repealed SICA in its entirety. The Sick Industrial Companies (Special Provisions) Repeal Act, 2003, No. 1, Acts of Parliament, 2004.

[119] *See* Balasubramanian et al., *supra* note 60, at 23–24. The authors found that of 301 companies that responded to their survey, only 6 had seen the Tribunal remove a CEO or other executive, remove a director, or order a special audit. *Id.* at 24.

[120] *Id.*

[121] India's judicial appointment process has been described as lengthy and cumbersome, leading to significant shortages in the number of judges. For example, in 2003, the number of judges serving on India's various high courts was 25% below the amount that was statutorily required. *See* Bhat, *supra* note 116, at 1449.

[122] The Companies (Second Amendment) Act, 2002, *supra* note 117.

of corporate governance standards through the NCLT, this process has led to little real change.

C. The Traditional Ownership Structure of Indian Firms

This section explains the two primary ownership structures prevalent in India: closed ownership structures and Public Sector Undertakings. As set forth in Part IV.I.2, *infra*, companies with these ownership structures have largely resisted India's corporate governance reform efforts.

1. Closed Ownership Structures

India's experience with corporate ownership resembles that of most emerging economies.[123] Corporate governance issues have long been a significant problem in emerging economies due to the complex and overlapping ownership and control structures evident in firms there. In these firms, management is generally tied to a controlling block of inside shareholders who have control rights in excess of their ownership rights.[124]

Historically, prior to independence, the prevailing model of ownership of Indian firms was the so-called "managing agency model."[125] Managing agencies, which functioned like holding companies, were business firms that contracted to manage the affairs of companies that issued stock. These agencies would then promote firms and used various means to exercise control. Not only did managing agencies use managing agency contracts to exercise control, but they also used:

> [T]heir prestige, past performance and signature . . . to ensure massive over-subscription of shares. Given excess demand, most of these companies could split shareholdings into small enough allotments to ensure that nobody—barring the managing agency—had sufficiently large stocks to ensure their presence in the board of directors. Dispersed ownership, thus, facilitated managing agencies to retain corporate control with relatively low equity ownership . . . .[126]

Post-independence, for the vast majority of Indian businesses, ownership has been concentrated in the hands of family business groups,

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[123] Jayati Sarkar & Subarata Sarkar, *Debt and Corporate Governance in Emerging Economies: Evidence from India*, 16 ECON. OF TRANSITION 293, 295 (2008).

[124] *See* La Porta et al., *supra* note 25, at 471.

[125] *See* Ananya Mukherjee Reed & Darryl Reed, *Corporate Governance in India: Three Historical Models and Their Development Impact*, *in* CORPORATE GOVERNANCE, ECONOMIC REFORMS, AND DEVELOPMENT: THE INDIAN EXPERIENCE 25, 31–36 (Darryl Reed & Sanjoy Mukherjee eds., 2004).

[126] Goswami, *supra* note 68, at 129.

and to a lesser extent, state-owned enterprises and promoters.[127] Ownership structures of firms in India were a primary factor behind the lack of disclosure and governance requirements under the Companies Act. Until very recently, Indian companies had little dependence on global capital markets for funds, as family business groups controlled the majority of large companies and financial intermediaries played minor roles in firm ownership.

Ownership of Indian firms has followed a complex pattern, with family ownership (and its accompanying control and conflicts of interest issues) being the mainstay of India's corporate landscape.[128] Even post-liberalization, a significant portion of the largest companies in India remained family-managed and promoted, although sometimes the controlling family may have had only modest ownership control.[129] According to a 2006 study, nearly sixty percent of India's 500 largest companies were affiliated with family business groups, and another eleven percent were wholly or significantly government-owned.[130] Even companies at the very top of India's corporate sector were family controlled. In 2006, of the companies on the BSE Sensitive Index (Sensex), representing the top thirty companies and accounting for nearly a fifth of the BSE's total market capitalization, nearly a third were family owned and controlled.[131] When the complete set of listed and non-listed Indian companies is considered, the percentage of family ownership jumps to seventy percent.[132] Some well-known examples of family-owned corporate groups are the Tatas, the Birlas, and the Ambanis.[133]

In addition to the prevalence of family and state ownership, "promoters" play an important and pervasive role in Indian corporate governance.[134] One study revealed that prior to the 1990s, as a result of the support of public financial institutions, the prominent industrial families were typically able to maintain operational control of large private

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[127] *See* Chakrabarti et al., *supra* note 54, at 59; *Family Businesses Raise Corporate Governance Concerns, Says Moody's*, INDIAN EXPRESS, Oct. 23, 2007, *available at* http://www.indianexpress.com/story/231282.html [hereinafter *Moody's*].

[128] Satheesh Kumar T. Narayanan, Indian Family-Managed Companies: The Corporate Governance Conundrum (2006) (unnumbered working paper), *available at* http://ssrn.com/abstract=1093230.

[129] *Id.* at 21.

[130] *See* Chakrabarti et al., *supra* note 54, at 59.

[131] Narayanan, *supra* note 128, at 20. In smaller listed companies on the BSE, which make up the largest portion of listed companies, family members generally own more than 50% of the company's shares. *See* SOM, *supra* note 63, at 7.

[132] Batra, *supra* note 86, at 174.

[133] *Moody's*, *supra* note 127.

[134] A promoter is any person or persons that have, directly or indirectly, control of the company. *See* Chakrabarti et al., *supra* note 54, at 61.

companies even with minimal diversification in shareholdings.[135] The study looked at the various companies held by several of the most prominent Indian families, and found that in nearly half the companies, at least twenty-five percent of the shares were held by public institutions.[136] For example, ten of the fifteen Tata companies and seven of the sixteen Birla companies included in the study revealed at least twenty-five percent public ownership.

However, with the 1990s came a change in strategy. As the economy became more liberalized, the various corporate promoters were faced with the threat of losing control in the face of significant increases in foreign investment.[137] These promoters began increasing their respective stakes in the companies they controlled, so much that a 2005 study of over 3000 companies found that nearly half the market capitalization of those companies was directly held by the promoters.[138] This study additionally suggested that the actual holdings likely exceed half, given that promoter shareholding is often hidden in the form of other corporate bodies or individual shareholders. In one case, the address provided by a company for a non-promoter corporate shareholder actually turned out to be that of the company's chairman.[139] Regardless of how frequent such hidden holdings actually are, it is clear that concentrated ownership still dominates the Indian corporate landscape. However, this concentration of ownership in India is slowly shifting. For example, non-promoter institutional investors, both Indian and foreign, are making significant inroads in the ownership of large Indian firms.[140]

2. Public Sector Undertakings (PSUs)

Public sector undertakings (PSUs), which are state owned enterprises, represent major remnants of the Indian government's socialist policies prior to 1991. PSUs have long occupied a dominant position in the Indian economy—India's public sector consists of over 1300 PSUs, which employed over seventy percent of the total industrial workforce.[141] "In 1980, public sector undertakings accounted for eighty percent of GDP and

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[135] K.S. Chalapati Rao & Atulan Guha, *Ownership Pattern of the Indian Corporate Sector: Implications for Corporate Governance* 1, 11 (Inst. for Studies in Indus. Dev., Working Paper No. 2006/09, 2006), *available at* http://isidev.nic.in/pdf/wp0609.pdf.

[136] *Id.* at 12.

[137] *Id.* at 11–14.

[138] *Id.* at 13.

[139] *Id.* at 13 n.20.

[140] *See* Chakrabarti et al., *supra* note 54, at 62. *But see* Rao & Guha, *supra* note 135, at 18.

[141] *See* Lawrence Sáez & Joy Yang, *The Deregulation of State-Owned Enterprises in India and China*, 43 COMP. ECON. STUD. 69, 76 (2001).

fourteen percent of non-agricultural GDP."[142] By 2003, PSUs accounted for thirty-two percent of BSE's market capitalization, with the government-controlled Oil and Natural Gas Corporation ranking first in market capitalization.[143] In fact, most listed PSUs "are larger in size, sales and value than their private sector counterparts."[144]

Beginning in the 1990s, as a part of India's economic liberalization, the government began large-scale privatization of PSUs. The government's privatization process became more aggressive from 2000 to 2004, but has slowed down in the past four years.[145] Therefore, a number of India's largest companies continue to have significant government ownership.

III. THE PROCESS OF FORMAL CONVERGENCE IN INDIA

Beginning in the late 1990s, the Indian government started implementing a significant overhaul of the country's corporate governance system. As described by a recent paper on Clause 49, these corporate governance reforms were aimed at "making Boards and Audit Committees more independent, powerful and focused monitors of management" as well as aiding shareholders, including institutional and foreign investors, in monitoring management.[146] India's corporate governance reform effort was channeled through a number of different paths and fraught with significant conflict between SEBI and the MCA. While SEBI proceeded to adopt considerable corporate governance reforms, the implementation and enforcement of such reforms have lagged behind. Clearly, the reforms adopted in India demonstrate formal convergence to the Anglo-American model of governance; however, the evidence is inconclusive as to whether this convergence has thus far moved beyond the formal level.

This part is organized as follows. Section A begins with an examination of the process leading to adoption of Clause 49, and the conflicts that arose between SEBI and the MCA in the reform process. Next, section B illustrates that Clause 49—which went through a series of amendments from initial adoption in 2000 to 2005 in order to enhance its effectiveness—in many ways resembles governance reforms adopted in developed countries, primarily those in the United States and the United Kingdom. Section C then goes on to survey the failures in the implementation and enforcement of Clause 49, and to consider how these failures demonstrate that reforms currently are primarily limited to formal changes.

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[142] *Id.*
[143] WORLD BANK REPORT, *supra* note 115, at 1.
[144] Goswami, *supra* note 68, at 135.
[145] PANAGARIYA, *supra* note 10, at 302–03.
[146] Dharmapala & Khanna, *supra* note 61, at 7.

A. Clause 49's Adoption—Challenges and Shortcomings

In 1998, SEBI formed a number of committees to help formulate corporate governance standards for publicly listed Indian companies. SEBI's governance reforms derived from the lobbying efforts of corporate leaders in India, particularly those familiar with the governance debate outside of India. After a detailed corporate governance code was proposed by a leading industry group, SEBI adopted the recommendations of the first committee formed to fashion a code of corporate governance and introduced unprecedented corporate governance reforms via Clause 49 of the Listing Agreement of Stock Exchanges.

Continuing its long-standing rivalry with SEBI, the MCA responded to SEBI's initial adoption of Clause 49 by establishing its own committees to propose corporate governance standards for Indian public companies through amendments to the Companies Act.

The MCA's process, however, was fraught with tensions with SEBI which appeared to be unhelpful in any process to amend the Companies Act. The failure of SEBI and the MCA to work together is especially evident in the process by which the agencies have approached the corporate governance framework in India. Specifically, SEBI has avoided encouraging amendment of the Companies Act to include corporate governance related provisions. Given the dynamic nature of the capital market and SEBI's need to remain flexible and responsive to changing situations, it may not be problematic that SEBI has preferred to enact change through amendments to the Listing Agreement and through committees. However, the opposition from the MCA to the convening of these committees provides further evidence that the two agencies are simply not on the same page.

Despite the MCA's attempts to amend the Companies Act, thus far Clause 49 remains the most significant corporate governance reform. Clause 49 established a new corporate governance regime. Like corporate governance standards in the United States and the United Kingdom, India's corporate governance reforms followed a fiduciary and agency cost model. With a focus on the agency model of corporate governance, the Clause 49 reforms included detailed rules regarding the role and structure of the corporate board and internal controls.[147] The Clause 49 reforms were phased in over several years, applying at first to larger entities and eventually to smaller listed companies.[148] Eventually thousands of listed

[147] Rajesh Chakrabarti, Corporate Governance in India—Evolution and Challenges 20 (Jan. 17, 2005) (unnumbered working paper), *available at* http://ssrn.com/abstract=649857.

[148] Not all publicly-traded and listed firms in India are required to comply with Clause 49. Clause 49 applies to all existing listed entities having a paid up share capital (number of shares outstanding multiplied by the face value of the shares) of Rs. 3 crores (30 million rupees, approximately $750,000) and above or net worth of Rs. 25 crores (approximately

Indian public companies were required to comply with a new corporate governance regime.

1. Industry's Role in Advocating Corporate Governance Reforms

India undertook efforts to improve its own corporate governance system in the late 1990s. As noted above, prior to the mid-1990s, India's corporate governance regime was particularly weak. Historically, there had been little emphasis on corporate governance mechanisms in India, as public companies in India were only required to comply with limited governance and disclosure standards enumerated in the Companies Act of 1956, the Listing Agreement, and the accounting standards set forth by the Institute of Chartered Accountants of India (ICAI).

India's first major corporate governance reform proposal was launched by the Confederation of Indian Industry (CII), India's largest industry and business association. CII—a non-government, not-for-profit, industry-led and industry-managed organization dominated by large public firms—has played an active role in the development of India's corporate governance norms.[149] In 1996, the CII formed a task force on corporate governance in order to develop a corporate governance code for Indian companies. Desirable Corporate Governance: A Code (CII Code) for listed companies was proposed by the CII in April 1998.[150] The CII Code contained detailed governance provisions related to listed companies.

The CII Code was heavily influenced by corporate governance standards found outside of India. Like many corporate governance codes, the CII Code initially notes that one system of corporate governance is not "unambiguously better than others[;] . . . [therefore, it could not] design a code of corporate governance for Indian companies by mechanically importing one form or another."[151] Nonetheless, it adopted at the outset the Anglo-American system's focus on shareholders and creditors.[152]

The CII Code was a significant step forward for a country not then known for robust corporate governance standards. However, the CII Code's voluntary nature did not result in a broad overhaul of governance norms and practices by Indian companies. Although the CII Code was

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$5.5 million) or more at any time in the history of the company. While all newly listed firms (i.e., those listed after 2000) must comply with Clause 49, existing listed companies with paid up share capital of less than Rs. 3 crore (approximately $750,000) are exempt from compliance. *See* CLAUSE 49 (2003), *supra* note 13.

[149] Confederation of Indian Industry, About Us, http://cii.in/menu_content.php?menu_id=3 (last visited Jan. 30, 2009). The CII also played an important role in the economic reform efforts of the 1990s. *See* MOOIJ, *supra* note 45, at 24.

[150] CONFEDERATION OF INDIAN INDUSTRY, DESIRABLE CORPORATE GOVERNANCE: A CODE (1998) [hereinafter CII CODE].

[151] *Id.* at 1.

[152] *Id.*

welcomed with much fanfare and even adopted by a few progressive companies, "it was felt that under Indian conditions a statutory rather than a voluntary code would be more purposeful[] and meaningful."[153]

2. *SEBI, the MCA and the Battle of the Committees*

a. The Birla Committee

Shortly after adoption of the CII voluntary code, SEBI sprang into action to develop corporate governance standards for publicly listed companies. SEBI's response was in part due to the CII's efforts to lobby SEBI to adopt mandatory governance reforms. A significant manifestation of SEBI's efforts to improve corporate governance standards in India was its appointment of several high-level committees to recommend revisions of Indian corporate governance standards.[154]

SEBI appointed the Committee on Corporate Governance (the Birla Committee) on May 7, 1999.[155] While SEBI has not disclosed the method by which it selected committee members, the Birla Committee included major industry representatives in India, including representatives from the CII and the All India Association of Industries.[156] The Birla Committee was chaired by Kumar Mangalam Birla, Chairman of the Aditya Birla Group, one of India's largest conglomerates with businesses that vary from petrochemicals and textiles to automobiles and information communication.[157] The Birla Committee also included a number of representatives from various stock exchanges in India, including the BSE

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[153] NATIONAL FOUNDATION, *supra* note 63, at 7.

[154] *See id.* at 7–8.

[155] SHRI KUMAR MANGALAM BIRLA ET AL., THE SEC. EXCH. BD. OF INDIA, REPORT OF THE KUMAR MANGALAM BIRLA COMMITTEE ON CORPORATE GOVERNANCE § 2.5 (1999), *available at* http://www.sebi.gov.in/commreport/corpgov.html [hereinafter BIRLA REPORT].

[156] *See id.* Mr. Vijay Kalantri, the President of the All India Association of Industries and Chairman and Managing Director of the Balaji Group, and Mr. Rajesh Shah, former President of the CII and Managing Director of Mukand Ltd., a specialty steel maker, where he was recently promoted to co-Chairman, both served on the Birla Committee. Other members of the committee included Mr. Murthy, Chairman of Infosys and who later served as the chairman of another SEBI committee formed to draft corporate governance rules, and Rohit Bhagat, then Vice President at the Boston Consulting Group and currently COO of Barclays Global Investors. *People on the Move*, EUR. PENSION & INV. NEWS, July 4, 2005, at 2, *available at* http://www.epn-magazine.com/news/fullstory.php/aid/1608/People_on_the_move.html.

[157] Aditya Birla Group, Our Group, Kumar Mangalam Birla Profile, http://www.adityabirla.com/the_group/km_birla_profile.htm (last visited Jan. 30, 2009). The Birla family is one of the foremost business houses in India. The Aditya Birla Group includes major Indian companies such as Hindalco, Grasim, and Ultra Tech Cement. Mr. Birla also serves as director for the Reserve Bank of India and the Board of Trade, as well as other prominent positions. *Id.*

and the NSE, as well as representatives from the ICAI and government agencies, including SEBI.[158]

The Birla Committee's recommendations were primarily focused on improving the function and structure of company boards and increasing disclosure to shareholders. The Birla Committee specifically invoked the U.S. Blue Ribbon Committee's emphasis on independent directors in discussing board recommendations.[159] With respect to company boards, the Committee made specific recommendations regarding board representation and independence.[160] The Committee also recognized the importance of audit committees and made many specific recommendations regarding the function and constitution of board audit committees.[161]

The Committee made several recommendations regarding disclosure and transparency issues, in particular with respect to information to be provided to shareholders. Among other recommendations, the Birla Committee stated that a company's annual report to shareholders should contain a Management Discussion and Analysis (MD&A) section, modeled after annual reports issued by companies in the United States, and that companies should transmit certain information, such as quarterly reports and analyst presentations, to shareholders.[162] Furthermore, with respect to

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[158] *See* BIRLA REPORT, *supra* note 155, at Annex. 1 (listing names of the committee members). The stock exchange representatives were (i) R.G. Patil, then Managing Director of the NSE; Mr. Patil had previously been highly involved in the Indian Banking sector, and is currently the Chairman of the Clearing Corp. of India Ltd. and Public Sector Divestment Commission with the Indian government; (ii) Anand Rathy, then President of the BSE; Mr. Rathu is also a chartered accountant, and has held several senior management positions in one of India's largest industrial groups; he also founded a successful full financial services firm focusing on wealth management, investment banking, and corporate finance; (iii) S.S. Sodhi, Executive Director of the Delhi Stock Exchange; and (iv) Kamal Parekh, former President of the Calcutta Stock Exchange who was forced to resign in 2001 in connection with insider trading scandals and was eventually charged with criminal violations. Other representatives included S.P. Chhajed, President of the ICAI, Dr. J. Bhagwati, then a joint secretary in the finance ministry, Samir Biswas, Regional Director of India's Department of Company Affairs, and L.K. Singhvi, then an Executive Director of SEBI. *Id.*

[159] BIRLA REPORT, *supra* note 155, at § 6.6.

[160] *Id.* §§ 6.5, 6.9. The Committee recommended that at least half the members should be independent (or one-third if the chairman of the board is an independent director), and defined an independent director as one who has no "material pecuniary relationship[, other than remuneration,] or transaction with the company [et al.] . . . which in the judgment of the board may affect [the director's] independence of judgment." *Id.* To ensure that directors give companies due attention, the Committee also recommended that directors be limited to holding a maximum of ten directorships and five chairmanships. *Id.* § 11.2.

[161] *Id.* § 9.6. The Committee recommended that the audit committee be composed of at least three directors, all nonexecutive directors, a majority of independent directors, and at least one director with financial and accounting knowledge. *Id.* The chair of the audit committee should be independent. In addition, the Committee recommended that the audit committee should meet at least three times a year. *Id.* § 9.7.

[162] *Id.* § 13.4, 14.7.

shareholder complaints, the Committee recommended that a board committee, chaired by a nonexecutive director, be formed to address grievances.[163]

SEBI implemented the Birla Committee's sweeping proposed reforms less than five months later in February 2000. At that time, SEBI revised its Listing Agreement to incorporate the recommendations of the country's new code on corporate governance. These rules—contained in Clause 49, a new section of the Listing Agreement—took effect in phases between 2000 and 2003. The reforms applied first to newly listed and large companies, then to smaller companies, and eventually to the vast majority of listed companies.[164]

b. The MCA Responds—The Chandra Committee

Following the addition of Clause 49 to the Listing Agreement, the MCA appointed its own separate committees to recommend corporate governance reforms to be incorporated into an amendment of the Companies Act. The first committee appointed by the MCA was formed in August 2002, following the enactment of Sarbanes-Oxley in the United States in July 2002. Chaired by Shri Naresh Chandra, a former Cabinet secretary, the committee was charged with undertaking a wide-ranging examination of corporate auditing and independent directors, although its report focused primarily on auditing and disclosure matters.[165] The Chandra Committee made a series of recommendations regarding, among other matters, the grounds for disqualifying auditors from assignments, the type of non-audit services that auditors should be prohibited from performing, and the need for compulsory rotation of audit partners. In addition, the Chandra Committee recommended greater consultations between SEBI and the MCA, noting that the overlap has "'adverse consequences' . . . with investors, companies and other stakeholders 'falling between the cracks.'"[166]

c. SEBI's Counter Response—The Murthy Committee

While the MCA believed corporate regulation was its exclusive domain, SEBI's reform efforts clearly indicated its opposing view. SEBI's

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[163] *Id.* § 14.12.

[164] For a discussion of the phase-in process under the initial Clause 49 adoption, see Black & Khanna, *supra* note 11; *see also*, Goswami, *supra* note 68, at 155 ("Today, listed companies accounting for over 95% of India's market capitalisation have to follow SEBI's corporate governance guidelines.").

[165] NATIONAL FOUNDATION, *supra* note 63, at 8.

[166] Sucheta Dalal, *Mouthing the DCA's Views*, FIN. EXPRESS, Mar. 10, 2003, *available at* http://www.financialexpress.com/news/mouthing-the-dcas-views/76027/ (quoting Chandra Committee).

response to the Chandra Committee illuminates the state of relations between the organizations. SEBI constituted another committee on corporate governance chaired by Shri N.R. Narayana Murthy which began meeting in the latter part of 2002.[167] SEBI appointed the Murthy Committee with terms of reference largely overlapping those of the Chandra Committee, a move the MCA strongly opposed.[168] Some in the financial press viewed this clash as detrimental to governance reform efforts, arguing that with each organization proposing conflicting reforms, the efforts were slowed and businesses were left in a state of uncertainty.[169] Despite much fanfare, the recommendations of the Chandra Committee did not result in legislative changes, although certain of its recommendations were incorporated in the report put forth by the Murthy Committee.

SEBI formed the Murthy Committee in the wake of the Enron scandal in the United States in order to evaluate the adequacy of the existing Clause 49 and to further improve existing practices in order to enhance the transparency and integrity of India's stock markets[170] and "ensure compliance with corporate governance codes, in substance and not merely in form."[171] The Murthy Committee, like the Birla Committee, described the international experience as a factor motivating reform. The Murthy Committee stated that recent failures of corporate governance, particularly in the United States, combined with the observations of India's stock exchanges that compliance with Clause 49 up to that point had been uneven, compelled the Murthy Committee to recommend further reform.[172]

The background of many of the Murthy Committee members mirrored those on the Birla Committee. Like the Birla Committee, many members of the Murthy Committee came from or had significant ties to well-established Indian companies.[173] The Chairman, Mr. Murthy, was Chairman and Chief

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[167] N.R. NARAYANA MURTHY ET AL., THE SEC. EXCH. BD. OF INDIA, REPORT OF THE SEBI COMMITTEE ON CORPORATE GOVERNANCE § 2.1 (2003), *available at* http://www.sebi.gov.in /commreport/corpgov.pdf [hereinafter MURTHY REPORT].

[168] Dalal, *supra* note 166; Y.H. Malegam, Birla Comm. Member, Address at the Fourth Nani Palkhivala Memorial Lecture: Corporate Governance (Jan. 10, 2004), *available at* http://prayatna.typepad.com/satya/files/2004_01_10_YH-Malegam_Corporate_ Governance.html.

[169] *See, e.g.*, K.R. Srivats, *India Inc. in a Bind Over SEBI Directive on Institutional Investors*, HINDU BUS. LINE, Sept. 2, 2003, *available at* http://www.thehindu businessline.com/2003/09/02/stories/2003090201820300.htm (noting difficulties for corporations when SEBI and DCA give conflicting reforms).

[170] MURTHY REPORT, *supra* note 167, § 1.6.3.

[171] *Id.* § 1.6.1.

[172] *Id.* §§ 1.5.4–1.5.5.

[173] *See* MURTHY REPORT, *supra* note 167, at 30. Major "captains of industry" included R. Gopalakrishnan (Executive Director of Tata Sons Ltd., as well as director of several other Tata Group companies), D.M. Satwalekar (Managing Director and CEO of HDFC Standard Life Insurance Company Ltd., and a member of the boards of several prominent Indian

Mentor of Infosys, one of India's best-governed companies.[174] In addition to representatives from major Indian corporations, the Murthy Committee included representatives from some of India's stock exchanges and industry groups.[175] SEBI representatives included some of those who had served on

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companies), and T.R. Ramaswami (former commercial and investment banker who went on to be the CEO of the Association of Merchant Bankers of India). *See Educated Investors Necessary for Sound Primary Market, Says AMBI Chief*, FIN. EXPRESS, Dec. 18, 2000, *available at* http://www.financialexpress.com/old/fe/daily/20001218/fns18054.html. Others with significant ties to prominent Indian companies included Y.H. Malegam (then Managing Partner and Chartered Accountant of S.B. Billimoria & Co., a prominent accounting firm, and a board member of the NSE and a number of prominent companies, including Siemens Ltd., Hindustan Construction Co. Ltd., and Tata Tea Ltd.). *See* Y.H. Malegam: Executive Profile and Biography, BUS. WK, *available at* http://investing.businessweek.com /businessweek/research/stocks/private/person.asp?personId=8369189&privcapId=22499164 &previousCapId=20332575&previousTitle=ABC%20Bearings%20Ltd. Ashook Soota (President of the CII who previously served as President of Wipro, and co-founded a leading IT consulting firm). *See* MindTree—About Us—Board of Directors—Ashok Soota, http://www.mindtree.com/aboutus/ashoksoota.html (last visited Jan. 30, 2009). Another with significant ties to prominent Indian companies was Omkar Goswami (Chief Economist at the CII until 2004, now a director at Infosys, the Editor of *Business India* magazine, and serving on the boards of several prominent companies, including Dr. Reddy's Laboratories Ltd.). *See* Infosys—About Us—Management Profiles—Dr. Omkar Goswami, http://www.infosys.com/about/management-profiles/omkar-goswami.asp (last visited Jan. 30, 2009).

[174] N.R. Narayana Murthy, *The World's Richest People,* FORBES.COM, http://www.forbes.com /lists/2006/10/7SE5.html (last visited Jan. 30, 2009).

[175] The Murthy Committee included Ravi Narain (the Managing Director and CEO of India's National Stock Exchange (NSE), who has also been a director of several companies); Manoj Vaish (then the CEO and Executive Director of the Bombay Stock Exchange, and later the CEO of Dun & Bradstreet Services India). *See* Mr. Ravi Narain, http://www.nfcgindia.org/r_n.pdf (last visited Jan. 30, 2009). Murthy Committee members from industry groups included A.C. Muthiah (President of the Federation of Indian Chambers of Commerce and Industry). *See A.C. Muthiah, President-elect of FICCI*, HINDU, Oct. 11, 2002, *available at* http://www.hinduonnet.com/2002/10/12/stories /20021012022 51800.htm. R.K. Somany (the President of the Associated Chambers of Commerce and Industry of India and also the Chairman and Managing Director of Hindustan Sanitaryware & Industries Ltd). *See R.K. Somany Chosen to Head Assocham*, HINDU BUS. LINE, Sept. 29, 2002, *available at* http://www.thehindubusinessline.com/2002/09/29/stories/20020929014 50300.htm. M.K. Doogar (Chairman of the Capital Markets Committee of PHD Chamber of Commerce and Industry, an organization dedicated to promoting industry, trade, and economic entrepreneurship in India). *See* PHD Chamber of Commerce and Industry Committees, http://phdcci.in/committees-tk.asp (last visited Jan. 30, 2009). Also A.K. Narayan (President of Tamilnadu Investor's Association, a group formed for the purpose of educating small investors and protecting investor interests). *See* TIA—About TIA, http://www.tia india.com/htm/tia_about.htm (last visited Jan. 30, 2009). Also M.K. Chouhan (Chairman of the Mahendra & Young Knowledge Foundation, an organization dedicated to fostering development of good corporate governance. In addition to serving on several boards, he is also Vice Chairman of the Global Advisory Board of the Asian Centre for Corporate Governance). *See* Chouhan Profile, http://www.nfcgindia.org/M%20K%20 Chauhan.pdf (last visited Jan. 30, 2009).

the Birla Committee, such as D.N. Raval and Pratip Kar, Executive Directors of SEBI.

Like the Birla Committee, the Murthy Committee examined a range of corporate governance issues relating to corporate boards and audit committees, as well as disclosure to shareholders. The Murthy Committee focused heavily on the role and structure of corporate boards and strengthened the director independence definition in the then-existing Clause 49, particularly to address the role of insiders on Indian boards.[176] For example, while the new definition actually encompassed the old, it also indicated, among other things, that the director cannot be related to promoters or management at the board level, or one below the board; an executive of the company in the preceding three years; a supplier, service provider, or customer of the company; or a shareholder owning two percent or more of the company.[177] The Murthy Committee also recommended that nominee directors (i.e., directors nominated by institutions, particularly financial institutions, with relationships with the company) be excluded from the definition of independent director, and be subject to the same responsibilities and liabilities applicable to any other director.[178] In order to improve the function of boards, the Murthy Committee recommended that they should also receive training in the company's business model[179] and quarterly reports on business risk and risk management strategies.[180]

The Murthy Committee paid particular attention to the role and responsibilities of audit committees. It recommended that audit committees be composed of "financially literate" members, with at least one member having accounting or related financial management expertise.[181] It provided a greater role for the audit committee as well. For example, the Murthy Committee recommendations promoted disclosure and approval of related party transactions by the audit committee.[182] In addition, the committee stated that whistle-blowers must have access to the audit committee without first having to inform their supervisors, and that companies should annually affirm that they have not denied access to the audit committee or unfairly treated whistle-blowers generally.[183]

Although SEBI initially implemented Clause 49 in 2000 in response to the Birla Committee's recommendations, Clause 49 reached its current

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176 MURTHY REPORT, *supra* note 167, § 3.10.14.
177 *Id.*
178 *Id.* §§ 3.8.1.1, 3.8.1.2.
179 *Id.* § 3.5.2.4.
180 *Id.* § 3.5.1.7.
181 MURTHY REPORT, *supra* note 167, § 3.2.2.3.
182 *Id.* § 3.4.1.5.
183 *Id.* §§ 3.11.1.3, 3.11.2.4.

form in response to the Murthy Committee's recommendations.[184] The Murthy Committee's report was released on February 8, 2003. The intention was to incorporate its main recommendations into SEBI's Listing Agreement. While there were many changes to Clause 49 as a result of the Murthy Report, governance requirements with respect to corporate boards, audit committees, shareholder disclosure, and CEO/CFO certification of internal controls constituted the largest transformation of the governance and disclosure standards of Indian public companies. As is clear in Part III.B below, many provisions of the revised Clause 49 mirror those found in Anglo-American models of corporate governance.

d. The MCA's Response to the Murthy Committee—The Irani Committee

Following appointment of the Murthy Committee by SEBI and revision of Clause 49, the MCA again sprang into action to attempt to revise the Companies Act. In December 2004, the MCA reconvened the Irani Committee.[185] The committee was led by J.J. Irani, a director of Tata Sons, Ltd.,[186] the primary shareholder in the large business conglomerate, the Tata Group.[187] The Irani Committee was to evaluate the Companies Act, with a focus on combining internationally accepted best practices in corporate governance with attention to the particular needs of the growing Indian economy.

The Irani Committee concluded that the best approach to corporate governance in India would be to construct a single framework of governance provisions applying to all companies so that all companies would be required to comply with a uniform set of rules.[188] However, the Irani Committee resisted the view that the regulation of public companies should be handed over entirely to SEBI, and argued that the central

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[184] SEBI, ISSUES UNDER CLAUSE 49 AND PROPOSED AMENDMENTS 1 (2003), *available at* http://www.sebi.gov.in/commreport/clause49.html; Posting of geetika to CAclubindia Blog, Articles on Clause 49 of Listing Agreement, http://www.caclubindia.com/articles/article_list_detail.asp?article_id=59 (last visited July 28, 2007).

[185] JAMSHED J. IRANI ET AL., EXPERT COMMITTEE ON COMPANY LAW, REPORT OF THE EXPERT COMMITTEE TO ADVISE THE GOVERNMENT ON THE NEW COMPANY LAW 3 (2005), *available at* http://www.primedirectors.com/pdf/JJ%20Irani%20Report-MCA.pdf [hereinafter IRANI REPORT]. In addition to the recommendations of the invited experts, a concept document was made available to the general public, along with a system for collecting opinions and recommendations from corporations, organizations, and individuals. *Id.* at 3–4, 35.

[186] Tata Group—Profiles—JJ Irani, http://www.tata.com/aboutus/articles/inside.aspx?artid=/hpowkTjfl o= (last visited Jan. 8, 2009).

[187] Tata Group—Our Businesses—Tata Sons http://www.tata.com/company/profile.aspx?sectid=DpOT+Lbrdvg= (last visited Jan. 8, 2009).

[188] IRANI REPORT, *supra* note 185, at 8–9.

government should play an important role with respect to corporate governance matters.[189]

Unlike the two SEBI-appointed committees, the Irani Committee recognized that requirements of special or small companies be accounted for through a series of exemptions, such that new small businesses are not burdened with the same level of compliance cost as larger, established corporations. In keeping with this theme, the Irani Committee recommended a wider set of classifications for companies than just the public or private labels, as the committee believed that the binary system of classification was too narrow to account for the varying needs of companies with different sizes and resources. The Committee's goal was to expand the system of classifications and exemptions to tailor compliance costs to needs, while maintaining sufficient regulatory stringency for large listed companies that access public capital.[190]

There are significant differences between the proposals contained in the Irani report and the requirements of Clause 49, particularly with respect to the board of directors. First, the requirements for independent directors are different in several respects. Clause 49 requires that no independent director have been an executive of the company in the preceding three financial years,[191] while the Irani Committee's recommendations weaken that requirement so that independent directors, along with their relatives,[192] have not been an employee of the company in any capacity in the past single year. Clause 49 prohibits independent directors from having served in any executive capacity in a statutory or internal auditing firm that has a material association with the company for the past three years, while the Irani report recommends the same requirement for a period of one year for independent directors and their relatives. The Irani Committee also recommends that a third of company directors be independent.[193] This recommendation follows on the heels of a firm statement by SEBI that there would be no excusal of noncompliance with the Clause 49 provision mandating that half of the board comprise independent directors. In addition, the Irani Committee recommends that no age limit be prescribed for independent directors,[194] and remained silent on the issue of term limits for directors, while the Murthy committee felt both were necessary.

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[189] *Id.* at 10–11.

[190] *Id.* at 11–12.

[191] CIRCULAR, SEC. & EXCH. BD. OF INDIA, CORPORATE GOVERNANCE IN LISTED COMPANIES—CLAUSE 49 OF THE LISTING AGREEMENT § I(A)(iii) (Oct. 29, 2004), *available at* http://www.sebi.gov.in/circulars/2004/cfdcir0104.pdf [hereinafter CLAUSE 49 (2004)].

[192] IRANI REPORT, *supra* note 185, at 37.

[193] *Id.* at 35.

[194] MURTHY REPORT, *supra* note 167, § 5.5.

3. *Competing Legislation: Clause 49 and Amendment of the Companies Act*

A major criticism regarding SEBI's attempts at governance reform involved its decision to reform the Listing Agreement rather than advocate for amendment of the Companies Act. SEBI's conflicts with the MCA led it to bypass the legislative route preferred by the MCA and attempt to regulate through the Listing Agreement. SEBI was criticized in particular for revising Clause 49 while many similar reforms were arguably included in then-pending legislation, the Companies (Amendment) Bill of 2003.[195] In particular, some questioned why SEBI would "resort to a hurried revision of Clause 49" when comparable reforms were being debated in Parliament.[196] SEBI's actions were seen as creating unnecessary expenses and efforts for corporations in addition to appearing as attempts to undermine the MCA.[197]

The criticism grew sharper following withdrawal of the Companies (Amendment) Bill in 2003. Many, including both press and industry insiders, felt SEBI should have suspended its Clause 49 revisions until the reforms could be fully considered legislatively.[198] Groups such as the Federation of Indian Commerce and Industry and the CII advocated that SEBI immediately withdraw the Clause 49 amendments.[199] When SEBI instead seemed to self-validate its actions through the Murthy Committee, which endorsed many of SEBI's Clause 49 revisions, some questioned whether SEBI's rule-making jurisdiction even covered its actions.[200] The title of an article in *The Hindu* sums up the feeling of many with respect to SEBI's actions concerning Clause 49: *SEBI, A Law Unto Itself*.[201] Viewing SEBI as having overstepped its authority, the press seemed to agree with the Chandra Committee that SEBI should only act through amendments to the Companies Act itself.[202] Even SEBI's own Murthy Committee, while

[195] T.N. Pandey, *SEBI Move: Clause and Effect*, REDIFF.COM, Dec. 29, 2003, http://www.rediff.com/money/2003/dec/29guest3.htm.

[196] *Id.*

[197] *Id.*

[198] *Corporates Train Their Guns on Listing Clause*, HINDU BUS. LINE, Oct. 22, 2003, *available at* http://www.thehindubusinessline.com/bline/2003/10/23/stories/2003102302680100.htm; Pandey, *supra* note 195.

[199] *Corporates Train Their Guns*, *supra* note 198.

[200] *See* Pandey, *supra* note 195 (arguing that SEBI's actions went beyond the scope of power conferred by Section 11(1) of the SEBI Act and Section 10 of the Securities Contracts (Regulation) Act).

[201] S. Balakrishnan, *SEBI, A Law Unto Itself*, HINDU, Oct. 10, 2005, at 19, *available at* http://www.hindu.com/2005/10/10/stories/2005101000441700.htm.

[202] *Id.* ("If any additional requirements are sought to be prescribed for listed companies, then in areas where specific provisions exist in the Act it would be appropriate for SEBI to have the requirements prescribed in the Act itself, through a suitable amendment.") (quoting

not condemning Clause 49 specifically, recommended that any differences between the Listing Agreement and the Companies Act be harmonized by legislative amendment.[203]

After failure of the first attempt to amend the Companies Act, the Irani Committee was formed in 2004 to promulgate a set of corporate governance recommendations for incorporation into the new Companies (Amendment) Bill. However, this process has also stalled. Although the MCA had previously said that the bill would be tabled during the winter 2007 session of Parliament, a ministry official later said that it was unlikely to happen.[204] After years of delay, the bill was introduced in the Indian Parliament in October 2008.[205] In order to become law, the Bill must be read three times in each house of Parliament (the Lok Sabha and the Rajya Sabha) before it is submitted to the President for assent.[206] As of October 2008, it was uncertain whether the bill will be passed and presented to the President.

B. Clause 49 and Anglo-American Corporate Governance Models

In light of the Birla and Murthy Committees' clear consideration of Anglo-American standards of governance, it is unsurprising that India's corporate governance reform effort should contain similar provisions to reform efforts outside of India that adopted such models.[207] In its final report, the Birla Committee noted its dual reliance on international experiences—both as an impetus for reform following "high-profile financial reporting failures . . . in the developed economies," and as a model

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Chandra Committee).

[203] *Id.* ("Major differences between the requirements of the listing agreement and the provisions of the Act should be identified and SEBI should then recommend to the Government that the provisions of the Act be changed to bring it in line with the requirements of the listing agreement.") (quoting Murthy Committee Report).

[204] Rupesh Janve & Siddharth Zarabi, *Now, Get Ready For the 'One-Person Company,'* REDIFF.COM, Nov. 26, 2007, http://www.rediff.com/money/2007/nov/26opc.htm.

[205] Press Release, Ministry of Corporate Affairs (India), Bill Intends to Modernize Structure for Corporate Regulation in This Country, (Oct. 23, 2008), *available at* http://www.pib.nic.in/release/release.asp?relid=44114.

[206] Lok Sabha—Passage of Legislative Proposals in Parliament, http://164.100.47.134 /newls/legislation/Legislation.htm (last visited Jan. 30, 2009). Following the recent accounting scandal at Satyam, there may be even further changes to the Companies bill that was introduced in the Indian Parliament in 2008.

[207] *Corporate Governance in India: Has Clause 49 Made a Difference?*, INDIA KNOWLEDGE@WHARTON, Jan. 25, 2007, http://knowledge.wharton.upenn.edu/india /article.cfm?articleid=4152. The six sources cited by the Birla Committee are: the Cadbury Report (U.K.); the Greenbury Recommendations (U.K.); the London Stock Exchange's Combined Code; the Confederation of Indian Industry's Desirable Corporate Governance Code; the OECD Principles of Corporate Governance; and the Blue Ribbon Committee Report (U.S.).

reform.[208] Significantly, the Birla Committee singled out U.S. and U.K. corporate governance reports and codes, such as the Report of the Cadbury Committee, the Combined Code of the London Stock Exchange, and the Blue Ribbon Committee on Corporate Governance in the United States.[209] The Committee even directly sought out the input of Sir Adrian Cadbury, chair of the Cadbury Committee commissioned by the London Stock Exchange, in addition to Indian business leaders.[210] The Committee itself also included a representative of a U.S. consulting firm and a professor from the London Business School.[211]

The current version of Clause 49 also reflects the report of the Murthy Committee. While this report did not explicitly cite to Anglo-American models of governance, it was clearly a reaction to events in the United States, particularly given the timing of the report, which followed just a few months after enactment of the Sarbanes-Oxley Act. While the Murthy Committee insisted that "corporate governance frameworks are not exportable," and that India must find a model suited to its particular needs, Clause 49 in its final form nonetheless echoes reforms in the United States and the United Kingdom.[212]

The comparison below demonstrates striking similarities between Clause 49 and the leading Anglo-American corporate governance standards, in particular the Cadbury Report, the OECD Principles of Corporate Governance, and Sarbanes-Oxley. The similarities (although not a complete overlap) are particularly significant with respect to provisions applicable to the board of directors, disclosure to shareholders, and internal controls. While certain details differ, Clause 49 reflects a set of rules dominated by concerns about the conduct of boards and protection of shareholder rights. The Appendix summarizes the principal provisions of Clause 49.

1. The Cadbury Report

In 1991, the Financial Reporting Council, the London Stock Exchange, and the accounting profession formed the Committee on the Financial Aspects of Corporate Governance.[213] Chaired by Sir Adrian Cadbury, the Committee considered board composition and responsibilities, the role and composition of audit committees, as well as other issues relating to

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208 BIRLA REPORT, *supra* note 155, §§ 1.1, 2.6.

209 *Id.* §§ 1.4, 2.6.

210 *Id.* § 2.11.

211 *Id.* at Annexure 1 (noting Shri Rohit Bhagat of Boston Consulting Group and Dr. Sumantra Ghoshal, Professor of Strategic Management, London Business School).

212 *Id.* § 2.6; MURTHY REPORT, *supra* note 167, § 1.1.14.

213 REPORT OF THE COMMITTEE ON THE FINANCIAL ASPECTS OF CORPORATE GOVERNANCE app. 1 (1992) [hereinafter CADBURY REPORT].

financial reporting and accountability.[214] The Committee published a report—the Cadbury Report—in December 1992, which contained recommendations. The Cadbury Report, often touted as the first corporate governance code of the modern era, has inspired corporate governance codes worldwide. It is clear from a brief comparison of Clause 49 and the Cadbury Report that there are significant similarities in the requirements they each impose on companies, particularly with respect to provisions applicable to the board of directors.

a. Board of Directors

The Cadbury Report and Clause 49 address general board matters in addition to audit committee issues. While the two have a similar focus, their specific provisions are not exactly in line. With respect to the board, the Cadbury Report requires at least three nonexecutive directors, with a recommendation that the majority of the nonexecutive directors be independent, but if the chairman is an executive, the board should have a "strong and independent element."[215] Clause 49, on the other hand, requires a majority of nonexecutive directors and either a third or a majority of independent directors depending on whether the chairman is also an executive.[216] While the Cadbury Report's board composition provisions are to some extent more open-ended than Clause 49's provisions, the Cadbury Report is also more general in its provision of broad recommendations for board procedure and responsibilities. It advises on board dynamics, the role and responsibilities of the chairman, the selection process for nonexecutive directors, director training, and board procedure, among others.[217] Though Clause 49 addresses other board issues such as number and timing of board meetings, it does not address these broader provisions. The Cadbury Report and Clause 49 are very similar in their provisions for audit committees. For example, both require companies to form audit committees with a minimum of three members and include independence requirements.[218]

b. Disclosure

While both Clause 49 and the Cadbury Report consistently encourage disclosure, Clause 49 focuses on disclosure to a greater extent than the

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214 *Id.*

215 *Id.* §§ 4.9, 4.12. The Cadbury Report's definition of independent is similar to Clause 49's, although far less detailed. *Compare id.* (outlining concepts of directors' financial independence, but leaving to individual boards of directors the task of fully defining director independence for a given company), *with* CLAUSE 49 (2004), *supra* note 191, § I(A)(iii) (enumerating six requirements for directors to be considered independent).

216 CLAUSE 49 (2004), *supra* note 191, §§ I(A)(i)-(ii).

217 CADBURY REPORT, *supra* note 213, §§ 4.1–.24.

218 CLAUSE 49 (2004), *supra* note 191, § II(A); CADBURY REPORT, *supra* note 213, § 4.35.

Cadbury Report. The provisions of each nonetheless overlap in several respects. Both require disclosure of director compensation.[219] Under Clause 49, companies must disclose and explain any deviation from prescribed accounting standards;[220] under the Cadbury Report, companies must state their compliance with the Report's requirements and disclose and explain any deviation.[221] Clause 49 also requires an MD&A section in a company's annual financial reports. Though the Cadbury Report does not explicitly require one, it discusses what might be seen as a precursor to the MD&A—the chairman's opening statement of a company report.[222] It notes the statement is of "special importance" and should provide a balanced summary of the company's performance and prospects, in comparison to Clause 49's review of industry developments, risks, performance, and opportunities.

c. Internal Controls

As with disclosure provisions, though Clause 49 goes into greater detail regarding internal controls than the Cadbury Report, they nonetheless overlap in significant respects. Specifically, both require internal control certification. They differ, however, in the details. Clause 49 requires the CEO and CFO to certify that they are responsible for establishing and maintaining internal controls, and that they have evaluated the effectiveness of the control systems implemented.[223] The Cadbury Report, on the other hand, provides that the directors are responsible for implementing an internal control system and certifying its effectiveness.[224] And while the Cadbury Report stops at this point, Clause 49 goes on to require the CEO and CFO to certify that they have reviewed the financial statement, that the statement does not contain any untrue statement of material fact, and that the statement fairly presents the company's financial position.

2. OECD Principles of Corporate Governance

In 1999, the OECD released its *Principles of Corporate Governance* (OECD Principles) in an effort to assist governments in improving and evaluating the corporate governance framework of their country.[225] Though it recognized that "[t]here is no single model of good corporate

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[219] CLAUSE 49 (2004), *supra* note 191, § IV(E); CADBURY REPORT, *supra* note 213, § 4.4.
[220] CLAUSE 49 (2004), *supra* note 191, § IV(B).
[221] CADBURY REPORT, *supra* note 213, § 3.7.
[222] *Id.*, § 4.57.
[223] CLAUSE 49 (2004), *supra* note 191, § V.
[224] CADBURY REPORT, *supra* note 213, §§ 4.31–.32.
[225] AD HOC TASK FORCE ON CORPORATE GOVERNANCE, ORG. OF ECONOMIC COOPERATION & DEV., OECD PRINCIPLES OF CORPORATE GOVERNANCE 2 (1999), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=174229 [hereinafter OECD PRINCIPLES].

governance," it identified common practices of its member countries that underlie good corporate governance.[226] The scope of the OECD Principles, however, is much broader than Clause 49. Most of its recommendations deal with basic issues of corporate governance, such as protecting shareholder rights,[227] treating shareholders equally,[228] basic principles of disclosure,[229] and basic board responsibilities.[230] In contrast, Clause 49 contains detailed provisions for board and audit committee compositions and internal control requirements.

Despite the OECD Principles' focus on fundamentals of corporate governance, Clause 49 does echo some of the recommendations made in the OECD Principles. Similarities are particularly evident in provisions regarding the board of directors. For example, the OECD Principles require disclosure of director remuneration.[231] In addition to reviewing general board responsibilities, the OECD Principles encourage boards to assign nonexecutive directors to financial reporting (audit), nomination, and remuneration committees.[232] Clause 49 has similar requirements, though its composition requirements are more specific.[233] Similarly, the OECD Principles require board members to devote sufficient time to their board responsibilities,[234] while Clause 49 specifically limits the number of other board positions a company's directors may hold.[235]

The annotations to the OECD Principles highlight further similarities. With respect to the audit committee composition and board responsibilities provisions mentioned above, the annotations make clear that the OECD Principles and Clause 49 are very similar. They explain that the board must have a sufficient number of independent directors, and that audit committees may require a minimum number of nonexecutive directors.[236] They also raise the possibility of limiting the number of board positions a

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[226] *Id.* at 3.

[227] *Id.* at 5 (giving shareholders the right to participate in decisions concerning fundamental corporate changes, the right to participate in general shareholder meetings, and the right to vote by proxy).

[228] *Id.* at 6 (prohibiting insider trading and requiring directors to disclose conflicts of interest).

[229] *Id.* at 8 (requiring audited financials).

[230] *Id.* at 9. For example, the OECD Principles require board members to "act on a fully informed basis, in good faith, with due diligence," and ensure compliance with applicable law. *Id.*

[231] OECD PRINCIPLES, *supra* note 225, at 8.

[232] *Id.* at 9.

[233] CLAUSE 49 (2004), *supra* note 191, § I(A)(ii) (requiring that independent directors compose two-thirds of the audit committee).

[234] OECD PRINCIPLES, *supra* note 225, at 22.

[235] CLAUSE 49 (2004), *supra* note 191, § I(C)(ii).

[236] OECD PRINCIPLES, *supra* note 225, at 43.

director can hold.[237] In addition, the annotations to the Principles recommend that MD&A sections be included in annual reports,[238] which Clause 49 explicitly requires.[239] And while the Principles only require annual audit by an independent auditor, the annotations suggest limitations on non-audit income that auditors may receive from clients as well as the establishment of audit committees and rotation of auditors.[240] Such provisions are found in Clause 49, though again in more detail.[241]

3. Sarbanes-Oxley

The Sarbanes-Oxley Act was passed in the United States in 2002 in the wake of the Enron scandal, the collapse of the tech bubble, and the WorldCom scandal. Although the provisions of the Sarbanes-Oxley Act have been subject to harsh criticism in the United States,[242] many in India view the Sarbanes-Oxley Act differently. Initially, at least, Indian academics, accountants, and lawyers not only thought it was a fair and appropriate law, but also looked to the Sarbanes-Oxley Act as a model of corporate governance law that India should emulate.[243]

As set forth below, the Sarbanes-Oxley Act and Clause 49 contain many similar provisions, although they do not entirely overlap with respect to the details of their various provisions. For example, although Clause 49 requires CEO/CFO certification of financial statements, it does not impose criminal liability in the event of a misstatement. And while the provisions of the Sarbanes-Oxley Act, such as the code of ethics and corporate governance guidelines, are echoed by Clause 49 provisions including the code of conduct, this is not universally the case. The provisions of the Sarbanes-Oxley Act regarding auditing and accounting have no analogue in Clause 49.

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[237] *Id.* at 44.

[238] *Id.* at 38.

[239] CLAUSE 49 (2004), *supra* note 191, § IV(F)(1).

[240] OECD PRINCIPLES, *supra* note 225, at 40.

[241] CLAUSE 49 (2004), *supra* note 191, § II.

[242] *See, e.g.*, Larry E. Ribstein, *Market vs. Regulatory Responses to Corporate Fraud: A Critique of the Sarbanes-Oxley Act of 2002*, 28 J. CORP. L. 1 (2002); Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L. J. 1521 (2005); *see also Five years Under the Thumb*, ECONOMIST, July 28, 2007; Stephen Labaton, *Will Reforms with Few Teeth Be Able to Bite?*, N.Y. TIMES, Sept. 22, 2002, at B4. *But see* Lawrence A. Cunningham, *The Sarbanes-Oxley Yawn: Heavy Rhetoric, Light Reform (And It Just Might Work)*, 35 CONN. L. REV. 915, 987–88 (2003); Robert A. Prentice & David B. Spence, *Sarbanes-Oxley As Quack Corporate Governance: How Wise is the Received Wisdom*, 95 GEO. L.J. 1843 (2007); D. Skylar Rosenbloom, *Take It Slow: A Novel Concept in the Life of Sarbanes-Oxley*, 63 WASH. & LEE L. REV. 1185, 1187 (2006).

[243] Sarita Mohanty, *Sarbanes-Oxley: Can One Model Fit All?*, 12 NEW ENG. J. INT'L & COMP. L. 1, 20 (2006).

a. Board of Directors

Both Clause 49 and the Sarbanes-Oxley Act focus on audit committee issues, as well as other board matters. As discussed above, Clause 49 deals extensively with board composition, imposing heightened independence requirements on boards. The Sarbanes-Oxley Act and Clause 49 even define "independent director" similarly.[244] Going beyond the Sarbanes-Oxley Act, Clause 49 mandates the number of meetings per year and even limits the number of directorships a director may simultaneously hold.[245]

Provisions of the Sarbanes-Oxley Act and Clause 49 dealing with the audit committee contain significant similarities. Both require public companies to have audit committees, though the composition varies slightly.[246] For example, the Sarbanes-Oxley Act requires each member of the committee to be independent, while Clause 49 specifies that the committee have at least three directors and requires only two-thirds to be independent.[247] Both require at least one financial expert, though Clause 49 indicates all members must be at least financially literate.[248]

b. Disclosure

Disclosure provisions make up major sections of both the Sarbanes-Oxley Act and Clause 49.[249] Nonetheless, the provisions largely diverge in their content. The Sarbanes-Oxley Act requires disclosures regarding off-balance-sheet transactions and pro forma figures.[250] It mandates accelerated reporting of trading by directors, officers, and principal stockholders.[251] Further, the SEC must give an enhanced review of

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[244] *Compare* CLAUSE 49 (2004), *supra* note 191, § I(A)(iii) (enumerating six requirements for directors to be considered independent, *with* Sarbanes-Oxley Act of 2002 § 301, 116 Stat. 745 (2002) (defining independence as "not receiving, other than for service on the board, any consulting, advisory, or other compensatory fee from the issuer, and as not being an affiliated person of the issuer, or any subsidiary thereof.").

[245] CLAUSE 49 (2004), *supra* note 191, § II(B).

[246] *Compare* CLAUSE 49 (2004), *supra* note 191, § II(A) (requiring two thirds of committee members to be independent directors), *with* Sarbanes-Oxley Act of 2002, *supra* note 244, § 301 (requiring all committee members to be independent directors).

[247] *Compare* CLAUSE 49 (2004), *supra* note 191, § I(A)(iii), *with* Sarbanes-Oxley Act of 2002, *supra* note 244, § 301.

[248] *Compare* CLAUSE 49 (2004), *supra* note 191, § II(A)(ii) (specifying "at least one member shall have accounting or related financial management expertise"), *with* Sarbanes-Oxley Act of 2002, *supra* note 244, § 407 (specifying company must disclose whether or not, "and if not, the reasons therefore, the audit committee . . . [has] at least one member who is a financial expert.").

[249] CLAUSE 49 (2004), *supra* note 191, § IV; Sarbanes-Oxley Act of 2002, *supra* note 244, at tit. IV.

[250] Sarbanes-Oxley Act of 2002, *supra* note 244, § 401.

[251] *Id.* §§ 402–403.

periodic disclosures, and may formulate rules requiring real time disclosure.[252]

Clause 49, on the other hand, focuses greater attention on disclosure to the audit committee. It requires disclosure of related party transactions and the use for any funding obtained through an IPO to the audit committee.[253] Additionally, companies must disclose and explain any deviation from prescribed accounting standards as well as nonexecutive director compensation.[254] Shareholders must also receive personal information regarding new or reappointed directors.[255]

c. Internal Controls

In contrast to the divergent disclosure provisions, the Sarbanes-Oxley Act and Clause 49 have similar internal control provisions. Both require chief executive and financial officers to certify financial reports.[256] Specifically, under both provisions the CEO and CFO must certify that they have reviewed the statement, that the statement does not contain any untrue statement of material fact, and that the statement fairly presents the company's financial position. In addition, they must certify that they are responsible for establishing and maintaining internal controls, and that they have evaluated the effectiveness of the control systems implemented.

The certification provisions diverge, however, in providing for penalties for failure to certify. The Sarbanes-Oxley Act provides criminal penalties, including fines of up to $5 million or twenty years in prison, for willful misstatements.[257] In addition, if a financial restatement is required as a result of material noncompliance with financial requirements, the CEO and CFO may have to disgorge bonuses and other incentive-based compensation.[258] Clause 49 does not provide criminal penalties for certification misstatements.

C. Compliance and Enforcement: The Weak Links

Clause 49 of the standard listing agreement with India's stock exchanges is a key component of India's "top-notch governance framework."[259] However, compliance and enforcement with this

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[252] *Id.* §§ 408–409.

[253] CLAUSE 49 (2004), *supra* note 191, §§ IV(A), (D).

[254] *Id.* §§ IV(B), (E)(iii).

[255] *Id.* § IV(G).

[256] *Id.* § V; Sarbanes-Oxley Act of 2002, *supra* note 244, § 302.

[257] Sarbanes-Oxley Act of 2002, *supra* note 244, § 906.

[258] *Id.* § 304.

[259] Joe Leahy, *Corporate Governance: Sustained Growth Needs Better Company Practices*, FIN. TIMES, Jan. 24, 2008 (quoting Manesh Patel, Partner, Ernst & Young), *available at* http://www.ft.com/cms/s/0/762d26ac-c946-11dc-9807-000077b07658,dwp

framework leave much to be desired. While many of the largest independent public companies appeared to have little difficulty complying, public sector and smaller companies have struggled to meet Clause 49's requirements. Interestingly, SEBI's approach to enforcement is tempered with experience; its broad initial threats of delisting evolved into a more reasoned, focused approach. SEBI has initiated a number of recent enforcement actions, with particular focus on PSUs; however, these proceedings have so far been limited.

Moreover, the recent corporate governance scandal involving Satyam, one of India's leading technology companies, will likely result in further evaluation of Clause 49 and the compliance and enforcement mechanisms currently in place.[260] SEBI's current chairman has indicated in recent speeches that he expects regulatory responses following the Satyam scandal.[261] At this time, it is too early to tell what such responses will entail and whether greater resources will be allocated to enforcement.

1. Gradual Implementation

The implementation of Clause 49 itself has taken place in stages. As of March 31, 2001, the original Clause 49 went into effect for all companies in the BSE 200, and all newly listed companies subsequent to that date, pursuant to the recommendations of the Birla Committee.[262] Compliance requirements were extended on March 31, 2002 to cover all listed companies with paid-up capital of Rs. 10 crore (100 million rupees, or approximately $2.2 million) or a net worth of Rs. 25 crore (approximately $5.5 million). Companies with a paid-up capital of Rs. 3 crore (approximately $750,000) were required to comply by March 31, 2003.[263] On August 26, 2003, SEBI entered amendments to Clause 49 pursuant to the recommendations of the Murthy Committee. The revised Clause 49 was planned to go into effect on March 31, 2004 for all companies that had been previously required to comply with the original Clause 49, as well as

_uuid=56c2aff4-be8c-11dc-8c61-0000779fd2ac.html. *See also* Vikas Varma, *Clause 49 Has Finally Found Its Claws*, LIVEMINT.COM, Oct. 15, 2007, http://www.livemint.com/2007/09/27143354/Clause-49-has-finally-found-it.html.

260 *See* Omkar Goswami, *Aftermath Of Satyam*, BUSINESSWORLD (India), Jan. 23, 2009, *available at* http://www.businessworld.in/index.php/Columns/Aftermath-Of-Satyam.html (arguing that Indian regulators need "the teeth to enforce [existing laws and regulations] with speed and decisiveness."); Prashant K Sahu, Sapna Dogra & Aditi Phadnis, *Satyam Scam Prompts Clause 49 Review*, BUS. STANDARD, Jan. 14, 2009, http://www.business-standard.com/india/news /satyam-scam-prompts-clause-49-review/05/05/346123/.

261 *See* Press Release, Confed'n of Indian Indus., No Knee Jerk Reaction in Satyam Issue but Regulatory Responses can be Expected: C.B. Bhave, Chairman SEBI (Feb. 5, 2009), *available at* http://cii.in/full_story.php?menu_id=78&news_id=2096.

262 MURTHY REPORT, *supra* note 167, at 35.

263 *Id.*

for all companies subsequently seeking listing for the first time.[264] However, this deadline was later pushed to January 1, 2006 after much complaint that the implementation process was moving too fast for smaller companies.

2. Compliance

While most recent figures indicate that large numbers of listed companies are not Clause 49 compliant, the bulk of the problem appears to rest with PSUs and smaller companies rather than top private sector firms. As explored below, this is in part due to political pressures regarding the PSUs and in part due to the traditional closed ownership structure of Indian firms.

Clause 49 compliance is reported by listed companies themselves. Under Clause 49, a quarterly report needs to be submitted to stock exchanges within fifteen days from the close of quarter, which is required to be signed by the CEO or the Compliance Officer.[265] Moreover, the company's annual report must contain a separate section on corporate governance.

To date, companies listed on the NSE have more fully complied with Clause 49 regulations than have BSE-listed companies. The NSE has grown rapidly in the past year. On March 2007, 1228 companies were listed in the capital market segment.[266] In October 2007, this number had increased to 1327.[267] As of October 31, 2008, 1623 securities were listed for trading.[268] According to the managing director of NSE, recent Clause 49 compliance data established that, as of October 2007, ninety-eight percent of the then-NSE-listed companies were in compliance.[269] It is not clear how the NSE arrived at this conclusion. In fact, according to recent data, approximately five percent of NSE-listed companied had not even filed their Clause 49 required corporate governance reports as of March 31, 2008.[270]

The BSE's compliance outlook appears to be weaker than that of the

[264] CLAUSE 49 (2003), *supra* note 13, at 13.

[265] CLAUSE 49 (2004) supra note 191, § VI(ii).

[266] NSE, LISTING OF SECURITIES 25, 30 (2007), *available at* http://nseindia.com /content/us/fact2007_sec3.pdf.

[267] M.C. Vaijayanthi, *NSE Listed Firms Toe the CG Line*, HINDUSTAN TIMES, Dec. 12, 2007, *available at* http://www.hindustantimes.com/StoryPage/StoryPage.aspx?id=f7751b65-84a1-40a6-8dd6-8ef29d830851&&Headline='NSE+listed+firms+toe+the+CG+line.

[268] NSE, About Us, Facts and Figures, http://nseindia.com/content/us/us_factsfigures.htm (last visited Jan. 30, 2009).

[269] Vaijayanthi, *supra* note 267.

[270] *See* NSE, List of Companies Which Have Not Submitted Corporate Governance Report for the Quarter Ended March 31, 2008 (on file with author). For updated data, see http://www.nseindia.com/content/equities/corpgov.csv.

NSE. Various reports have indicated different compliance rates for BSE-listed companies. According to one report, as of January 2007, 4143 companies were listed on BSE and were required to comply with Clause 49 regulations.[271] However, Clause 49 compliance stands at only forty-three percent, with only 1789 companies in compliance.[272] As of February 1, 2007, 2020 companies out of the 4149 companies listed on the BSE were not Clause 49 compliant, according to Deepak Parekh, the Chairman of SEBI's primary market advisory committee.[273] According to another set of data, by March 2008 at least 1213, or approximately thirty percent, of the companies on the BSE remained noncompliant.[274]

While the BSE overall noncompliance rate ranges from thirty to around fifty percent, the numbers for top private sector companies appear to paint a very different picture. In January 2006, when revisions to Clause 49 went into effect, the top ten private sector companies were all in compliance.[275] By March 2007, only thirteen of the 204 BSE Group A companies were noncompliant.[276]

In marked contrast to large private sector companies, PSUs were mostly noncompliant with Clause 49 by large margins at the time it went into effect.[277] And so they have remained; as recently as February 2008, none of the listed PSU oil companies were Clause 49 compliant.[278] The overwhelming issue for PSUs has been Clause 49's independent director requirements.[279] In particular, SEBI has maintained that government nominees on PSU boards are not independent per Clause 49's requirements.[280]

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[271] More recently, as of December 2007, more than 4700 companies were listed on BSE. BSE, Introduction, http://bseindia.com/about/introbse.asp (last visited Jan. 30, 2009).

[272] R. Bijith, *57% BSE Cos Yet to Comply with Clause 49*, FIN. EXPRESS, Jan. 2, 2007, *available at* http://www.financialexpress.com/old/print.php?content_id=150610.

[273] *'Punish Cos for Clause 49 Non-Compliance,'* BUS. LINE (MUMBAI), Feb. 20, 2007, http://www.blonnet.com/2007/02/20/stories/2007022005030100.htm.

[274] Corporate Filing & Dissemination System, Companies Not Complying with Clauses 49 & 40A, http://www.corpfiling.co.in/notcomplying/links.aspx (last visited Jan. 30, 2009).

[275] *PSUs Fail SEBI's Clause 49 Test*, FIN. EXPRESS, Jan. 10, 2006, http://www.financialexpress.com/fe_full_story.php?content_id=114055.

[276] *SEBI Proceeds Against 20 Cos for Not Complying with Clause 49 Norms*, HINDU BUS. LINE, Sept. 12, 2007, *available at* http://www.thehindubusinessline.com/2007/09/12/stories/2007091252930100.htm.

[277] *PSUs Fail SEBI's Clause 49 Test*, *supra* note 275.

[278] Rakteem Katakey, *Govt for 33% Independent Directors in Oil PSUs*, BUS. STANDARD (New Delhi), Feb. 18, 2008, *available at* 2008 WLNR 3117239.

[279] *PSUs Fail SEBI's Clause 49 Test*, *supra* note 275.

[280] *SEBI Cracks Whip on 20 Firms for Clause 49 Violation*, BUS. STANDARD, Sept. 12, 2007, *available at* 2007 WLNR 17748098.

3. Enforcement

India is not a country known for vigorous enforcement of legislation. Thus far, the enforcement of Clause 49 has mirrored the lax enforcement efforts of other major legislative reforms. There is little information regarding enforcement of Clause 49 as SEBI has not provided much disclosure to the public regarding these efforts. What is known, at least with respect to large entities, is that there has been little use by SEBI of the delisting enforcement measure provided under Clause 49, even for companies that have failed to comply with Clause 49's board independence rules.[281] Similarly, the NCLT has failed to exercise its enforcement powers with respect to corporate governance matters.[282]

Clause 49 contained certain penalty provisions for noncompliance. While the initial penalty for failure to comply with Clause 49 was delisting, severe financial penalties for directors of non-compliant firms were introduced in 2004. Effective October 12, 2004, by virtue of the Securities Laws (Amendment) Act, 2004, a defaulting company became liable for monetary penalties under the provisions of Section 23E of the Securities Contracts (Regulation) Act, 1956 (SCRA), which provides that "[i]f a company . . . fails to comply with the listing conditions or delisting conditions or grounds or commits a breach thereof; he shall be liable to a penalty not exceeding twenty five crore rupees."[283]

a. Evolution of SEBI's Enforcement Philosophy

Not only has compliance with Clause 49 been weak, enforcement has also been lacking. There is little enforcement of corporate governance norms through private litigation. Despite India's sophisticated investor-protection laws, litigants may never be able to meaningfully access the courts.[284] As the World Bank found in its 2005 report, "it is not unusual for

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[281] Balasubramanian et al., *supra* note 60, at 7, 14.

[282] *Id.* at 23–24.

[283] *See* The Securities Laws (Amendment) Act, 2004 § 11, No. 1, Acts of Parliament, 2005, *available at* http://indiacode.nic.in/fullact1.asp?tfnm=200501; *see also* Dharmapala & Khanna, *supra* note 61 (finding that a large and significant positive effect on the value of firms as a result of the Clause 49 reforms and the 2004 sanctions).

[284] The Companies Act states that it:

> [C]onfers rights to shareholders in matters of oppression by the majority or mismanagement. The lesser of 100 shareholders or those representing 10 percent of shareholders can apply to the CLB for redress. CLB can instruct management to buy out dissenting shareholders, terminate or modify agreements entered into by the company or remove/appoint directors to the board. CLB's decisions may be appealed to the high and supreme courts.

WORLD BANK REPORT, *supra* note 115, at 6.

the first hearing to take six years and the final decision up to 20 years."[285]

With the weak possibility of enforcement through the courts, enforcement has essentially been relegated to the activities of SEBI. Perhaps because it has observed the difficulties companies have had complying with Clause 49, SEBI's enforcement philosophy has changed since Clause 49's effective date. Early statements from Chairman Damodaran indicated that SEBI would prosecute noncompliant companies with enthusiasm; in fact, SEBI anticipated receiving compliance reports from the stock exchanges within a month of Clause 49's effective date.[286] Not only was it eager to track down noncompliant companies, but also it seemed anxious to impose a severe penalty; Chairman Damodaran threatened that SEBI was developing delisting standards while it waited for the noncompliant list.[287]

Within a few months of Clause 49's effective date, SEBI had toned down its message. Although Chairman Damodaran was still calling for tough action against noncompliant companies in April 2006, he maintained that SEBI did not "want an adversarial relationship" with listed companies.[288] Rather than calling for action against all noncompliant companies, Damodaran suggested SEBI might investigate fifteen to twenty and make examples of four or five of them to discourage noncompliance.[289] Furthermore, delisting is arguably not a particularly credible threat since many listed companies—by some estimates eighty-five of listed companies—have minimal trading of their stock.[290]

By late 2006, SEBI's early eagerness appeared to further give way to a more tempered approach to enforcement. In Damodaran's own words, SEBI's "approach to implementation [would not be] that of a trigger-happy kid."[291] Recognizing the potential harm to investors accompanying delisting, he indicated SEBI would take a more cautious approach to meting out such a severe penalty.[292] SEBI would focus its enforcement efforts on those companies that possessed the means to comply, but that had failed to

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[285] *Id.*

[286] *SEBI Gets Tough with Corp Governance Defaulters*, ECON. TIMES (INDIA), Jan. 11, 2006, *available at* 2006 WLNR 538409.

[287] *Id.*

[288] *Clause 49: SEBI Warns Erring Cos*, HINDU BUS. LINE, Apr. 8, 2006, *available at* http://www.blonnet.com/2006/04/08/stories/2006040804640100.htm.

[289] *Id.*

[290] NATIONAL FOUNDATION, *supra* note 63, at 6.

[291] *'No Exemption from Clause 49 Compliance,'* HINDU BUS. LINE, Aug. 30, 2006, *available at* http://www.thehindubusinessline.com/2006/08/31/stories/2006083103700900.htm.

[292] *Id.* (quoting Damodaran as saying, "[w]e cannot suspend or de-list companies from the exchanges without having a closer look at the matter. SEBI, as market regulator, has the primary objective of protecting investors.").

take the necessary steps to do so, while companies that had made a good faith effort to comply, but had fallen short, would be encouraged to complete compliance rather than be prosecuted.[293]

While Damodaran has embraced a more tempered approach to enforcement since Clause 49's effective date, whether SEBI will continue with this philosophy is an open question. On February 18, 2008 C.B. Bhave was appointed as SEBI's new chairman.[294] As of yet, Chairman Bhave has declined to comment on his future plans for enforcement of Clause 49.[295]

b. Enforcement Actions to Date

SEBI brought its first enforcement actions in September 2007—years after Clause 49 went into effect.[296] Although some view SEBI's enforcement proceedings as evidence it has moved into "the next phase of implementation and institutionalization of corporate governance norms in India," many are less sanguine about Clause 49's overall effectiveness.[297] As former Chairman Damodaran predicted over a year earlier, SEBI brought adjudication proceedings against only twenty out of the hundreds of noncompliant companies.[298] Though it did not disclose all of the names of the companies, SEBI indicated fifteen were private companies and five were PSUs.[299] All of the PSUs failed to meet Clause 49's independent director requirements, while only three of the private sector companies failed to comply with board, audit committee, and CEO/CFO certification requirements.[300] This is unsurprising given the PSUs' overall failure to appoint the required numbers of independent directors.[301] Three of the private sector companies were noncompliant with almost all of Clause 49's major provisions, and the remaining ten had failed to submit Clause 49

[293] *Id.*

[294] *CB Bhave Takes Charge as SEBI Chairman*, ECON. TIMES (INDIA), Feb. 18, 2008, *available at* http://economictimes.indiatimes.com/Markets/Indices/C_B_Bhave_takes_charge_as_SEBI_Chairman/articleshow/2792714.cms.

[295] *Id. See also Bhave May Be New SEBI Chairman*, TIMES OF INDIA, Feb. 14, 2008, *available at* http://timesofindia.indiatimes.com/Bhave_may_be_new_SEBI_chairman/articleshow/2780836.cms (describing Bhave's background and reputation for not bowing to pressure).

[296] Press Release, SEBI, SEBI Initiates Adjudication Proceedings Against 20 Companies for Non-Compliance of Clause 49 Norms (Sept. 11, 2007), *available at* http://www.sebi.gov.in/press/2007/2007257.html.

[297] *SEBI Proceeds Against 20 Cos, supra* note 276.

[298] *Id.*

[299] *Id.*

[300] *Id.*

[301] *PSUs Fail SEBI's Clause 49 Test, supra* note 275.

compliance reports to the stock exchanges.[302]

In addition to adjudication proceedings, SEBI has also been enforcing Clause 49 through blocking initial public offerings of companies not meeting its requirements.[303] Many of the noncompliant companies facing IPO delay are PSUs without the requisite number of independent directors. For example, India's second largest oil and gas exploration company, Oil India Ltd. (OIL), did not have its IPO as planned in February 2008 due to noncompliance.[304] SEBI has also delayed IPOs for the National Hydroelectric Power Corporation (NHPC) and the Rural Electrification Corporation, both of which were to have gone public in mid-2007, because of issues regarding approval of independent directors.[305]

IV. CONVERGENCE UNFULFILLED

While the Clause 49 reforms at first appear to reflect convergence to the Anglo-American model, a deeper look at the process leading to India's sweeping corporate governance reforms and the implementation and enforcement of those reforms demonstrate that such convergence is formal at best. Despite efforts by India's corporate elite to shape and control the corporate governance reform efforts, India's complicated politics have continued to stymie such efforts. As argued by the Asian Corporate Governance Association in 2007, India's corporate governance regime has remained weak despite enactment of Clause 49.[306] There are numerous factors that contribute to continuing weakness in India's corporate governance regime.

This section examines the reasons for the flawed implementation and enforcement process that proceeded from enactment of Clause 49. These path dependent forces have prevented convergence to the Anglo-American model from moving much beyond the formal level. This section discusses the barriers to comprehensive convergence, focusing on interagency struggles between SEBI and the MCA, the lingering concentrated ownership structure of Indian firms, and the lack of public and private institutional infrastructure to implement reforms. It then concludes with the

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[302] *SEBI Proceeds Against 20 Cos*, *supra* note 276.

[303] Rakteem Katakey, *OIL Share Offer Falters on Board Composition*, BUS. STANDARD, Jan. 12, 2008, *available at* 2008 WLNR 631056; *NHPC Public Offer in Danger for Non-Compliance of Clause 49*, FIN. EXPRESS, Jan. 24, 2008, *available at* 2008 WLNR 1378536.

[304] Katakey, *supra* note 303.

[305] *Id.*; *NHPC Public Offer in Danger*, *supra* note 303; Subhash Narayan & Niranjan Bharati, *Issue of Independent Directors Delay NHPC IPO*, ECON. TIMES (INDIA), Feb. 2, 2008, *available at* 2008 WLNR 1949642. *See also NHPC IPO Only Next Fiscal*, BUS. LINE, Feb. 20, 2008, *available at* 2008 WLNR 3244494.

[306] Asian Corporate Governance Association, Library, Country Snapshots, India, http://www.acga-asia.org/content.cfm?SITE_CONTENT_TYPE_ID=11&COUNTRY_ID=264 (last visited Mar. 1, 2007).

ramifications of the Indian corporate governance experience for the convergence debate.

A. Barriers to Convergence

1. Ramifications of Inter-Agency Struggles

Since the late 1990s the MCA has been engaged in what has been termed a "turf war" with SEBI over the process for and substance of corporate governance reform, among other things.[307] Many commentators view the conflicts between SEBI and the MCA as a leading cause of lax enforcement of corporate governance standards.[308] Despite the relative homogeneity of the Birla and Murthy Committees, criticism of the process that culminated in the revisions of Clause 49 did not focus on the committees themselves. Rather, one of the most significant issues with respect to the reform process related to SEBI's conduct vis-à-vis the MCA and SEBI's decision to pursue corporate governance reform through amendments to the Listing Agreement, rather than through revisions to the Companies Act with participation from the legislative branch.

One of the reasons that corporate governance reforms were pursued through SEBI was that, as an independent market regulator, SEBI provided some flexibility to a corporate governance regime primarily characterized by a need for constant amendment of the Companies Act. The promulgation of comprehensive reforms in the form of Clause 49 demonstrates this. Although SEBI has had long-standing tensions with the MCA over who should be handling the various tasks involving reform and enforcement of corporate governance standards, it is worth noting that since SEBI's inception, it has taken significant steps to pursue formal convergence with Anglo-American systems of governance through changes to the Listing Agreement, while MCA's proposed reforms of the Companies Act have languished in drafting and review.

Despite SEBI's ability to push Clause 49 through, the MCA's resistance to its provisions, including recommendations by MCA-appointed committees that conflicted with Clause 49, has significantly undermined SEBI's authority and lifted much of the pressure from non-complying companies. The "[l]ack of cooperation and coordination between key

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[307] Sucheta Dalal, *Irani Panel Hasn't Helped Small Investors*, FIN. EXPRESS, June 6, 2005, *available at* http://www.financialexpress.com/old/fe_full_story.php?content_id=92958 (noting DCA and SEBI committees propose contradictory reforms; calling Irani Committee's proposals "a direct snub to SEBI"); Mishra & Srivats, *supra* note 104.

[308] Ambarish Mukherjee, *Delayed Action Against Errant Co—Turf War Between SEBI and DCA*, HINDU BUS. LINE, July 16, 2001, *available at* http://www.hinduonnet.com/businessline/2001/07/16/stories/14161830.htm (noting turf war caused delay of investigations).

government departments, in particular MCA and SEBI," further weakened enforcement and implementation efforts, resulting in "overlap of jurisdiction or regulatory gaps." [309] Furthermore, as argued by the ACGA, India has "a penchant for setting up official committees and enacting new regulations, but under-investing in enforcement and implementation. Neither SEBI nor MCA seem [sic] to have enough competent staff who truly understand the capital markets . . . it will be quite a while before serious changes are seen."[310]

2. Ownership Structures and Resistance to Reforms

Unlike the reaction to corporate governance reforms in other developing countries, Clause 49 was not initially met with much resistance, partly because of industry's leading role in the reform process. [311] Unlike governance reforms in many countries that arise as a result of major corporate scandals, the process of governance reforms in India was initiated by industry leaders—in particular, the CII. Industry leaders were particularly concerned with adopting governance reforms that could help them attract investors—particularly foreign investors. Indeed, Indian industry leaders have continued to work closely with the government in promoting corporate governance reforms.[312]

Not only were industry leaders intricately involved in developing and drafting India's corporate governance reforms, but investors also viewed the Clause 49 reforms positively.[313] In fact, what is shocking is how little opposition there was to the corporate governance reforms initially proposed through Clause 49. Despite the fact that the most active proponents of these reforms were large firms who could more easily bear their implementation costs, smaller firms voiced little opposition to the reforms.

Larger Indian firms in particular seemed to welcome Clause 49's reforms because they appear to have benefited from the more robust corporate governance rules imposed by Clause 49. In their event study of the impact of Clause 49 reforms on the market value of Indian firms, Professors Black and Khanna found a significant rise in the share price of large firms following SEBI's initial announcement to adopt corporate

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[309] Asian Corporate Governance Association, *supra* note 306.

[310] *Id.*

[311] *See* Daniel Berkowitz, Katharina Pistor & Jean-François Richard, *Economic Development, Legality and the Transplant Effect*, 47 EUR. ECON. REV. 165 (2003).

[312] In 2004, the MCA established the National Foundation for Corporate Governance (NFCG) in partnership with Confederation of Indian Industry (CII), Institute of Company Secretaries of India (ICSI) and Institute of Chartered Accountants of India (ICAI). *See* National Foundation for Corporate Governance, About Us, http://www.nfcgindia.org aboutus.htm (last visited Jan. 30, 2009).

[313] Black & Khanna, *supra* note 11, at 18.

governance reforms similar to those proposed by the CII. This result reflected investor expectations that corporate governance reforms would "increase the market values of larger Indian public firms."[314] Furthermore, Professor Black and Khanna found that fast-growing and cross-listed firms both reacted more positively than other firms, consistent with the theory that "faster-growing firms are more likely to raise equity capital, and may benefit more from the bonding to good governance" and "cross-listed firms may have greater investment by governance-sensitive foreign investors."[315]

While large corporate entities have been relatively successful at implementing Clause 49's reforms, PSUs and small- and medium-sized enterprises have struggled with the implementation process. One of the biggest failures of corporate governance reforms in India has been the inability of corporate governance reforms to reach these entities. Many experts believe that despite India's formal governance standards, the "fundamental reality of Indian business—most are still controlled by family shareholders" or are government-controlled—undermines the effectiveness of these standards.[316]

There are several explanations for the compliance discrepancy between top private sector companies and PSUs and smaller private companies. Top private companies have a particular motive to be viewed as practicing good corporate governance as they are competing for foreign direct investment.[317] While top companies have strong incentives to increase transparency and compliance, smaller private companies and PSUs have faced many compliance obstacles.[318] The traditional closed or government-controlled ownership structures of Indian firms have resulted in weak boards and weak board practices. As identified by the World Bank, "a key missing ingredient in India today is a strong focus on director professionalism."[319]

The closed ownership structure of Indian firms, along with significant government control of large PSUs, has meant that there is little shareholder activism in India, and investors spend little time communicating their

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[314] *Id.* at 1.

[315] *Id.*

[316] Leahy, *supra* note 259. *See also* Marianne Bertrand, Paras Mehta & Sendhil Mullainathan, *Ferreting Out Tunneling: An Application to Indian Business Groups*, 2002 Q.J. ECON. 121.

[317] Varma, *supra* note 259.

[318] *'Punish Cos for Clause 49 Non-Compliance,' supra* note 273.

[319] Michael F. Carter, Country Director, India, The World Bank Group, Address at the National Conference on Corporate Governance Trends in India (Oct. 18, 2004) (transcript available at http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTGOVANTI CORR/0,,contentMDK:20269936~menuPK:3036142~pagePK:64020865~piPK:149114~the SitePK:3035864,00.html) (emphasis omitted).

concerns to the board of directors or the management of a firm.[320] In India, there are no significant shareholder associations, and minority shareholders have minimal avenues for protecting their rights. Even large "institutional investors show minimum involvement in corporate governance issues."[321]

The family business structure of many Indian firms compounds this difficulty; family control can contribute to issues of adaptability and transparency, and many family businesses do not have nomination committees.[322] In fact, one of the main concerns regarding Clause 49 has been whether it can be effective given the structure of many Indian businesses, where board members may be reluctant to question leaders of family run businesses. For example, many argue that it is highly unlikely that a board would ever oust leaders like Ratan Tata of the Tata Group.[323] Thus, "family control . . . [raises] corporate governance concerns in areas including adaptability, leadership transition, checks and balances and transparency."[324]

The PSUs have also resisted reform. The PSUs have argued that their non-compliance is due to the allegedly onerous independent director requirements of Clause 49. According to many PSU leaders, while they recognize the need for more independent directors, the process for appointments takes significantly more time than private company appointments because the government must appoint these directors.[325] SEBI Chairman M. Damodaran has suggested the government is dragging its heels in appointing independent directors because it does not want to lose control over PSU companies.[326]

Even the largest and most important PSUs have been in conflict with SEBI and Clause 49's independent director requirements. For example, the Oil and Natural Gas Company (ONGC), one of the PSUs against which it is publicly known that SEBI has proceeded, has been the center of controversy surrounding the strict enforcement of independent director

[320] *See* Jayati Sarkar & Subrata Sarkar, *Large Shareholder Activism in Corporate Governance in Emerging Economies: Evidence from India*, 1:3 INT'L REV. FIN. 161 (2000); M.C. Vaijayanthi, *Shareholder Activism*, HINDUSTAN TIMES, Dec. 26, 2007, *available at* http://www.hindustantimes.com/StoryPage/StoryPage.aspx?id=4b5beaf0-3847-47ad-994b-38f92a294d22&&Headline=Shareholder+activism; C.V. Baxi, *Grooming Independent Directors to Be Change Agents*, FIN. EXPRESS, June 25, 2005, *available at* http://www.financialexpress.com/old/fe_full_story.php?content_id=94703.

[321] Vaijayanthi, *supra* note 320.

[322] Leahy, *supra* note 259.

[323] *Id.*

[324] *Id.*

[325] *'PSUs Must Meet Clause 49 Norms,'* BUS. STANDARD, Jan. 3, 2008, *available at* 2008 WLNR 96448.

[326] *Id.*

requirements.[327] Shortly after SEBI initiated the adjudication proceeding against ONGC, the Ministry of Petroleum requested that SEBI drop the proceedings, as well as the proceedings against two other oil PSUs.[328] Petroleum Secretary M.S. Srinivasan assured SEBI that the companies would have the required number of independent directors, but that compliance would take "a little more time."[329]

Following SEBI's rejection of a compliance deadline extension and reminder that penalties for noncompliance include delisting, ONGC Chairman Sharma argued that Clause 49's independent director requirements were unnecessary for PSUs.[330] According to Chairman Sharma, because PSUs are highly regulated, accountability is higher and Clause 49's requirement is therefore excessive.[331] The PSUs have advocated that SEBI should instead enforce the J.J. Irani Committee on Company Law's recommendation that only a third of their directors be independent.[332]

Sharma's argument provoked a harsh response from SEBI. Chairman Damodaran refused to dilute Clause 49's requirements.[333] He was particularly concerned that if people were investing in Indian companies based on the perception that "Indian corporates are trying to get their act together on corporate governance," Indian companies should follow through on that perception.[334]

Despite outgoing Chairman Damodaran's response, the public reaction from other PSU leaders has been agreement with Sharma.[335] Off the

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[327] Richa Mishra, *ONGC Faces Threat of Delisting*, HINDU BUS. LINE, Nov. 12, 2007, *available at* 2007 WLNR 22305224.

[328] Anupama Airy, *Centre Tells SEBI to Drop Proceedings Against PSUs*, FIN. EXPRESS, Nov. 3, 2007, *available at* http://www.financialexpress.com/news/Centre-tells-Sebi-to-drop-proceedings-against-PSUs/235512/.

[329] *Id.*

[330] Mishra, *supra* note 327.

[331] *Id.*

[332] K.R. Srivats, *'Independent Directors Should Form 1/3 of Board' Irani Panel Submits Report on Company Law*, HINDU BUS. LINE, June 1, 2005, *available at* http://www.blonnet.com/2005/06/01/stories/2005060102690100.htm.

[333] *No Exemption for Listed PSUs on Independent Director Norms*, HINDU BUS. LINE, Jan. 3, 2008, *available at* 2008 WLNR 93975. *See also 'PSUs Must Meet Clause 49 Norms,' supra* note 325 (noting Damodaran replied at a corporate governance conference where Sharma was also speaking); *SEBI Won't Budge on Clause 49 Norms*, FIN. EXPRESS, Jan. 2, 2008, *available at* http://www.financialexpress.com/news/Sebi-wont-budge-on-Clause-49-norms/257004/ (quoting Chairman Damodran as commenting that Sharma's suggestion that "corporate governance requirement[s] should be less [stringent] for PSUs is something I cannot persuade myself to agree with . . . ." and that "the solution should be found elsewhere.").

[334] *No Exemption for Listed PSUs*, *supra* note 333.

[335] *'PSUs Must Meet Clause 49 Norms'*, *supra* note 325.

record, however, these leaders recognize the need for more independent directors to ensure PSUs can compete effectively for capital.[336] Nonetheless, since the announcement of Chairman Bhave's appointment, the Petroleum Ministry has taken up Sharma's argument.[337] The MCA has also indicated that it supports board composition of one-third independent directors.[338] An oil company official has indicated his belief that the proposal will carry more weight with SEBI's new chairman.[339]

3. Weaknesses of the Judiciary

While the formal codes and structures of Indian governance are highly reflective of the U.S. and U.K. systems they have been modeled after, the actual operations of those institutions, and of the judiciary in particular, reflect distinctly local forces. As discussed in Part II.B.4 above, the Indian judicial system is characterized by staggering delays in adjudication. The delays in the Indian judiciary have meant that the corporate governance reforms and measures to protect shareholders have generally not been enforced through the courts.

In order to ameliorate the extreme backlog of corporate law cases and to consolidate various duties previously allocated to several different government bodies, in 2002, the Indian Parliament amended the judicial structure with respect to corporate law matters. Under The Companies (Second Amendment) Act, 2002 (2002 Act), the government created the NCLT, along with its appellate body, the NCLAT, to enforce the provisions of the Companies Act.[340] One of the government's hopes was that corporate governance reforms could be enforced by this new judicial body.

Unfortunately, this judicial reform process has been stalled. On April 10, 2004, the Madras High Court declared the NCLT to be an unconstitutional infringement upon the independence of the judiciary.[341] The Madras High Court objected to several provisions of the 2002 Act creating the tribunal, including provisions regarding expertise of technical members of the tribunal, the three year term for tribunal members, and the process of appointment of the president and chairman of the tribunal.[342] On

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[336] *Id.*

[337] Katakey, *supra* note 278.

[338] *Id.*

[339] *Id.*

[340] The Companies (Second Amendment) Act, 2002, *supra* note 117.

[341] *National Company Law Tribunal Held Unconstitutional*, HINDU BUS. LINE, Apr. 11, 2004, *available at* http://www.thehindubusinessline.com/2004/04/11/stories/2004041101480100.htm.

[342] *Id.* The 2002 Act mandated that technical members of the tribunal would have 20 years experience in science, technology, banking, and other fields. However, the court felt that experience in these diverse areas was no substitute to expertise in the particularities of company law. The court also felt that the three year terms for members were too short, and

May 18, 2007, the Supreme Court of India heard the petitioner's appeal. Since the issues involved would have serious implications for the balance of power between the branches of the Indian government, the case was given to a five-judge Constitution Bench of the Court to decide.[343] No final ruling had been handed down as of March 2009, and thus far the NCLT has not been established.[344]

B. Lessons for the Convergence Debate

The active debate regarding the extent of convergence between different corporate governance systems has led to two polar positions: the position arguing that convergence to the Anglo-American model is largely complete and the opposing argument that political and path dependent forces will limit convergence. A third important intermediate position is taken by scholars who recognize that changes in formal standards, while exhibiting one level of convergence, can be ineffective without an infrastructure for implementation and enforcement.

This Article suggests that while a country can adopt formal rules that move it towards an Anglo-American model, its convergence to this model will be hampered by political and social forces. Formal rules will play an important role in a country's overall governance system, but reforms cannot be widely instituted without proper enforcement institutions and widespread political support for reform. As demonstrated by the struggles between SEBI and the MCA, and the weaknesses in India's judicial system, these enforcement institutions are difficult to change.

India was well-poised to go down the path of formal corporate governance convergence. The trajectory of India's corporate governance reform efforts was shaped by India's vast economic growth and the attempts of India's corporate elites to access new foreign and local capital. These forces placed competitive and political pressures on the Indian government to improve its formal corporate governance standards and to develop legal rules based on Anglo-American corporate governance

discouraged competent people from joining. Although it was stipulated that members who join the tribunal could maintain a lien on their jobs, the court felt that this was a cumbersome way to conduct business. Finally, the 2002 Act provided that the president of the tribunal and chairman of the appellate tribunal would be selected by a panel of secretaries, but the court felt that, as officers performing essential judicial functions, they must be appointed by the Chief Justice of India in consultation with the two most senior justices on the Supreme Court.

343 *SC Refers NCLT Issue to Constitutional Bench*, ECON. TIMES (India), May 18, 2007, http://economictimes.indiatimes.com/News/PoliticsNation/SC_refers_NCLT_issue_to_constitutional_bench/articleshow/2059145.cms.

344 *See, e.g., No Easy Cure for Industrial Sickness*, ECON. TIMES, Jan. 2, 2008, at 16, *available at* http://economictimes.indiatimes.com/Policy/No_easy_cure_for_industrial_sickness/articleshow/2667172.cms.

practices. From decades of almost non-existent corporate governance, India's current regime now exhibits some of the same formal governance rules instituted in more developed economies. According to one influential scholar of the Indian economy, "India is sort of a noisier version of the U.S. system."[345]

Despite extensive governance rules, large numbers of companies have been unable to comply with new governance standards and Indian regulators have been slow, at best, to enforce these new standards. According to a recent review of India's governance by the Asian Corporate Governance Association, Indian enforcement and implementation of Clause 49 is, at best, weak: "Most mid- and small-cap companies do not see the value of corporate governance. Most listed companies, including many large ones, take merely a box-ticking approach."[346] A number of factors, including regulatory competition between two government institutions, an inefficient judicial system, and the sustained closed ownership structure of Indian firms, have created barriers that prevent these robust formal rules from being implemented and enforced.

India's reform efforts thus provide an interesting pattern of corporate governance convergence for they can be characterized as either formal convergence toward the Anglo-American governance practices, or as continuing persistence of the traditional weak corporate governance norms long-evident in India. Despite the initial exuberance about Clause 49 and promises of rigorous enforcement, implementation and enforcement of Clause 49 demonstrate that while formal convergence may have been achieved, complete convergence requires greater institutional changes.

What are some of the lessons we can learn from India's corporate governance experience and the ensuing enforcement and implementation process? It becomes clear that even with attentive crafting of detailed governance rules by a group of elites with a deep understanding of corporate governance standards around the world, the reform process is useless if an effective infrastructure for enforcement and implementation is not in place. Thus, the corporate governance reform process must take account of these limitations in the crafting of new standards. Convergence cannot be complete with adoption of formal rules alone; true convergence requires similarities in implementation and enforcement.[347] In fact, introducing formal rules into a system where there is an inadequate

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[345] William J. Holstein, *Corporate Governance in China and India*, BUS. WK, Mar. 6, 2008, *available at* http://www.businessweek.com/managing/content/mar2008/ca2008036_282896.htm.

[346] *See* Asian Corporate Governance Association, *supra* note 306.

[347] Gérard Hertig, *Convergence of Substantive Law and Convergence of Enforcement: A Comparison, in* CONVERGENCE AND PERSISTENCE IN CORPORATE GOVERNANCE 328 (Jeffrey N. Gordon & Mark J. Roe eds., Cambridge University Press 2004).

infrastructure to support the implementation and enforcement of such rules may mean that these rules have little chance of succeeding.[348] Moreover, even if the infrastructure is in place, as the debates between SEBI and the MCA illustrate, reform efforts are not likely to have a significant impact on the country's governance norms unless there is cohesive political support for them.

Undoubtedly the trajectory of India's corporate governance reforms and whether complete convergence to the Anglo-American model will occur will be shaped largely by local factors.[349] India's corporate governance experience establishes that there are important political and social factors that shape the evolution of a nation's corporate governance system. These factors place such enormous pressures on countries that convergence of different national systems in a single direction is unlikely to happen in the near future, regardless of how well placed each national system is to replicate one model of governance.

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[348] *See* William Easterly, *Institutions: Top Down or Bottom Up?*, 98:2 AM. ECON. REV.: PAPERS AND PROCEEDINGS 95, 96 (2008).

[349] *See* Curtis J. Milhaupt, *Property Rights in Firms, in* CONVERGENCE AND PERSISTENCE IN CORPORATE GOVERNANCE 210 (Jeffrey N. Gordon & Mark J. Roe eds., Cambridge University Press 2004).

APPENDIX—AN OVERVIEW OF CLAUSE 49

Board of Directors:

Independence

- Requirement—fifty percent independent directors if Chairman is an executive director or thirty-three percent if Chairman is a non-executive.
- Definition—no material pecuniary relationship or transactions with the company, its promoters, its management or its subsidiaries, not related to Board or one level below Board and no prior relationship with the Company for the last three years.
- Nominee Directors of Financial Institutions—considered independent.

Board Requirements & Limitations

- Meet four times a year (maximum three months between meetings).
- Director may be on at most ten committees and chair of at most five.
- Code of Conduct (Ethics) required.

Audit Committee:

Composition

- At least three directors (two-thirds must be independent).
- All must be financially literate.
- At least one must have accounting or financial management experience.
- Chairman of the committee should be an independent director, who should be present at Annual General Meeting to answer shareholder queries.

Audit Committee Role & Powers

- Minimum of four meetings per year (gap between meetings not exceed four months).
- Broad role—review statutory and internal auditors as well as internal audit function, oversee a company's financial reporting process and quality of disclosure of financial information, and review whistleblower program if one exists, amongst other things.
- Powers to (i) investigate any activity within its terms of reference; (ii) seek information from any employee; (iii) obtain outside legal or other professional advice; and (iv) secure attendance of outsiders with relevant expertise, if necessary.

Disclosures:

- Related party transactions.

Disclosures (continued):

- Accounting treatments and departures.
- Risk management.
- Annual report includes a detailed chapter on Management Discussion and Analysis, including a discussion on industry structure and developments, opportunities and threats, segment-wise or product-wise performance, outlook, risks and concerns, internal control systems and their adequacy, relating financial performance with operational performance, and issues relating to human resource development.
- Proceeds from offerings.
- Compensation for directors (including non-executives) and obtain shareholders' approval.
- Details of compliance history for last three years.
- Corporate governance reports (and disclose adoption, if any, of mandatory and non-mandatory requirements). Noncompliance with any mandatory recommendation with their reasons should be specifically highlighted.
- For appointment or re-appointment of a director, shareholders must be provided with the following information: (i) a brief resume of the director; (ii) nature of his expertise in specific functional areas; and (iii) companies in which he holds directorships.
- Information like quarterly results, presentation made by companies to analysts, etc., should be put on the company's web-site and sent in such a form so as to enable the stock exchange on which the company is listed to put it on its own web-site.

Certifications:

- CEO & CFO: financial statements; effectiveness of internal controls; legal transactions; and inform audit committee of any significant changes in the above.
- Auditor or Company Secretary certifies compliance with corporate governance.

Other Recommendations:

- Whistleblower policy is optional.
- Independent directors lose status as "independent" if served nine years at company.
- Training board members.
- Evaluate non-executive board performance.