

# Corporate Governance

## A Case Study of Textile Industry of Punjab

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### INTRODUCTION

The textile industry is the dynamic, growth oriented industry with strong technological bases. The Indian textile industry enjoys major strengths in the global market. It is largely self-sufficient with regard to raw material, with India's cotton crop, being the third largest in the world. India has achieved self sufficiency in synthetic raw material as well as mainstream products like polyester staple fiber, polyester filament yarn, and acrylic fiber and viscose fiber though certain specialty polyester fiber and yarn are yet to improve.

Substantial growth in the domestic market and tremendous upswing in the international and domestic market, as a result (if free market access is facilitated by GATT), spells a bright scenario for Indian Textile industry. New opportunities are emerging in downstream products like processed fabrics and finished and branded knit and woven garments with improvement in communications and electronic data transfer.



The textile economy is the second sector of Indian economy, next only to agriculture, in terms of production, employment, exports and consumption. About one-tenth of India's population depends on it for their livelihood.

### The major textile industries of Punjab are: -

1. M/s Jagatjit Cotton Textile mills Ltd. Phagwara. 2. Nahar Exports Limited, Ludhiana. 3. Abhishek Industries Ltd. Ludhiana. 4. Malwa Cotton Spinning Mills Limited, Ludhiana. 5. Oswal Woolen mills Ltd. Ludhiana. 6. The Barnala Co-operative Spinning mills Ltd. Sangrur. 7. Suraj Textile Mills, Muktsar. 8. Arihant Spinning Mills, Malerkotla. 9. Himachal Fibres Ltd., Solan.

### CORPORATE GOVERNANCE-THE CONCEPT

The perpetual need for transparency in reporting and accountability has laid emphasis on adoption of measures, policies and practices commonly termed as "corporate governance practices".

Corporate governance is the combination of two words: Corporate + Governance

**Corporate:** - According to the dictionary meaning, the word corporate means a company.

**Governance:** - Concise oxford dictionary defines it as "act or manner of governing".

Corporate governance is a system by which companies are directed and controlled. It includes the policies and procedures adopted by a company in achieving its objectives in relation to its shareholders, employees, customers and suppliers, regulatory authorities and societies at large.

Monks and Minow have defined corporate governance as relationships among various participants in determining the direction and performance of a corporation.

CII (Confederation of Indian Industry)-Desirable corporate governance code defined corporate governance as follows:-

"Corporate Governance deals with laws, procedures, practices and implicit rules that determine a company's ability to take informed managerial decisions. The governance deals with laws, procedures, practices and implicit rules that determine a company's ability to take informed managerial decisions vis-a-vis its claimants-in particular, its shareholders, creditors, customers, the state and employees. There is a global consensus about the objective of 'good' corporate governance; maximizing long-term shareholder value.

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***The Kumar Mangalam Birla Committee constituted by SEBI has observed that:***

"Strong corporate governance is indispensable to silent and vibrant capital markets and is an important instrument of investor protection. It is the blood that fills the veins of transparent corporate disclosure and high quality accounting practices. It is the muscle that moves a viable and accessible reporting structure."

The Institute of Company Secretaries of India has also defined the corporate governance as under: -

"Corporate governance is the application of best management practices, compliance of law in true letter and spirit and adherence to ethical standards for effective management and distribution of wealth and discharge of social responsibility for sustainable development of all stakeholders."

***OECD (Organization of Economic co-operation and Development) has defended corporate governance as: -***

"The system by which business corporations are directed and controlled." This definition encompasses four elements:

- Distributing authority among constitution of corporate working;
- Defining rules and establishing procedures for attaining corporate objective;
- Making those charged with governance and management accountable;
- Creating and maintaining channels of information and disclosure.

Corporate governance, thus, seeks to establish control system and structure in an organization. It Guides decision making process to ensure high degree of accountability to stakeholders and builds credibility by creating and maintaining an effective channel of information and disclosure.

## **GOOD CORPORATE GOVERNANCE- A PARAMETRIC PERSPECTIVE**

Good governance is integral to the very existence of a company. It inspires and strengthens investor's confidence by ensuring company's commitment to higher growth and profits. The corporations have realized that management without governance practices is like a ship without a sail. The significance of the accountability coupled with transparency cannot be undermined, as the managers responsible for managing the affairs of a corporation are merely the custodians of the assets owned by it.



Corporate Governance Practices-Self regulation vis-a-vis legislation

The debate over 'self regulation or legislation in corporate world' is quite old now. Indian corporate scenario would justify the legislation of corporate practices. Confederation of Indian Industries codified the corporate governance practices many years ago but its compliance was non-existing until and unless the securities and Exchange Board of India made it mandatory on the recommendation of Kumar Mangalam Birla Committee set up.

The corporations have realized that management without good governance practices is like a ship without a sail. The significance of the accountability coupled with transparency cannot be undermined, as the managers responsible for managing the affairs of a corporation are merely the custodians of the assets owned by it.

**Self-Regulation vis-a-vis legislation:** Now for the big question, whether corporate governance practices should be in the form of self regulation only or should they be legislated?

**Legislation** means 'declaration of legal rules by a competent authority'. Once Corporate Governance practices are legislated, they lose the voluntary character; they become mandatory. On the other hand, self-regulation demands that corporates should follow the corporate governance practices voluntarily without any shadow of compulsion. According to this view, the corporate governance practices should be adhered to by the corporates as their obligation, more akin to eminent jurist Prof. H.L.A. Hart's concept of law, who emphasized that law is concerned with obligation rather than compulsion.

The Indian corporate scenario would justify the legislation of corporate practices. Confederation of Indian Industries (CII) codified the corporate governance practices many years back but its compliance was non-existent. It was only after Securities Exchange Board of India (SEBI) made it mandatory on the recommendation of Kumar Mangalam Birla Committee set up by it that the listed companies began embracing them.

A comparison of differential requirement as per SEBI guidelines and Companies Act 1956 clearly brings out the variations in Corporate Governance practices.

Sub-clause of Clause 49	Requirement	Section of Companies Act, 1956	Requirement
I(A)	Composition of Board of Directors 50% of the total number of directors should be <b>non-executive directors</b> If chairman is an executive chairman, at least half of the total number of directors should be <b>independent directors</b> . If the chairman is a <b>non-executive chairman</b> , at least 1/3rd of the total number of directors should be independent directors.	--	No such requirement under the companies act, 1956.  In fact, the Companies Act, 1956 does not use the expressions 'independent directors' or 'non-executive directors' or 'executive directors' or 'executive or non-executive chairman'.
II (A)	Composition of Board of Directors 50% of the total number of directors should be <b>non-executive directors</b> If chairman is an executive chairman at least half of the total number of directors should be <b>independent directors</b> . If the chairman is a <b>non-executive chairman</b> , at least 1/3rd of the total number of directors should be independent directors.	--	No such requirement under the companies act, 1956.  In fact, the Companies Act, 1956 does not use the expressions 'independent directors' or 'non-executive directors' or 'executive directors' or 'executive or non-executive chairman'.
II (B)	All <b>pecuniary</b> relationship of transactions of non-executive director's vis-a-vis the company should be disclosed in Annual Report.	299	This section requires disclosure by directors of their interests in contrast and arrangements with the company. It is only a disclosure of information (Form 24AA) and there is no requirement of stating the same in annual Report as it is under Clause 49 except the disclosures to be made pursuant AS-18-Related Party Disclosures.
III (A)	<b>Composition of Audit Committee</b> a) The audit committee should consist of - <b>Minimum of 3 members, all being non-executive directors.</b> <b>Majority of them being independent (At least one director having financial and accounting knowledge)</b> b) Chairman to be an independent director c) Chairman to attend Annual General Meeting d) Committee to invite Finance Director, head of Internal Audit, representative of statutory auditor to attend the meetings. e) Company secretary to act as secretary to the committee	292A	Applicability of section 292A Section 292A applies to all public companies having a paid-up capital of Rs. 5 crore or more. Composition of audit committee a) The audit committee to consist of- <b>Not less than 3 directors 2/3rd of which shall be directors other than managing or whole-time directors</b> b) Chairman to be elected by the members c) Chairman to attend Annual General meeting. Director incharge of finance, Internal Auditor and statutory auditor shall attend the meetings without any right to vote.
(B)	<b>Meetings of Audit Committee</b> To meet at least thrice a year. One meeting to be held before finalization of annual accounts One meeting to be held every six months  <b>Quorum</b> <b>Two members or one-third of the members of the audit committee, whichever is higher and minimum of two independent directors.</b>		<b>Meetings of Audit Committee</b> <b>Frequency of meetings is not specified u/s 292A.</b> However, it states that Audit Committee should have periodical discussions with auditors regarding scope of audit and review of half-yearly and annual financial statements before submission to the Board and also ensuring compliance of internal control systems. <b>Quorum</b> <b>No quorum has been specified in Section 292A. The quorum should, thus, be as per Articles of Association of the company.</b>
(C)	<b>Powers of Audi Committee</b> To investigate any activity within its terms of reference To seek information from any employee To obtain outside legal or other professional advice To secure attendance of outsiders with relevant expertise if necessary.	292A(7)	<b>Powers of Audit Committee</b> To investigate into any matter in relation to items specified in section 292A or referred to it by the Board. To have full access to information contained in the records of the company. To seek external professional advice if necessary.

(D)	Remuneration of Directors	309 (1)	Remuneration of Directors
	The remuneration of non-executive directors to be decided by the Board of Directors.		Section 309 (1) of the Companies act requires the remuneration of directors (whether executive or non-executive directors) to be determined by the resolution of the Board and the shareholders.
IV	<b>Frequency of Board Meetings</b> The board meetings shall be held at least four times a year, with a maximum time gap of four months between any two meetings.	285	<b>Frequency of Board Meetings</b> The board meeting to be held once in every three months and at least four such meetings to be held every year. The gap between two meetings could be more than 4 months.
V	<b>Disclosures in respect of personal interest of the members of the management of the company</b> Disclosures to be made by the management to the board relating to all material financial and commercial transactions, where they have personal interest, that may have potential conflict with the interest of the company at large (for e.g. dealing in company shares, commercial dealings with bodies, which have shareholding of management and their relatives etc.)	299	<b>Disclosure of interest</b>  Disclosure of interest u/s 299 relates disclosure by the directors in respect of direct-indirect interest in any contract or arrangement with the company. The phrase 'members of the management' used in clause seems to be much wider. However, who will be covered in the expression 'member of the management' has not been specified.
VI	<b>Report on Corporate Governance</b> The company shall have a separate section on Corporate Governance in annual reports of company, with a detailed compliance report on Corporate Governance.	--	<b>Report on Corporate Governance</b> <b>No separate report on corporate governance is required under the companies act, 1956.</b>
VII	<b>Compliance Certificate from Auditors</b> The company has to- a) Obtain a certificate from auditors of company regarding compliance of conditions of corporate governance as stipulated in this clause. b) Annexe certificate with directors' report, which is sent annually to all shareholders. c) Send same certificate to Stock Exchanges along with annual returns filed by company.	--	<b>Compliance certificate from Auditors</b> No such requirement under the Companies Act, 1956.

## RESEARCH METHODOLOGY & OBJECTIVES OF STUDY

This chapter describes in detail, the procedure adopted to achieve the objectives of the study. The research was carried out keeping in mind the objectives of the study so as to get meaningful information for the purpose of analysis.

The study involved the use of both primary and secondary data. Primary data was collected to study corporate governance practices followed by companies. The secondary resources were collected from annual reports and websites of companies. This chapter deals with-

1. Data collection 2. Sample design and selection 3. Research framework.

### 1. Method of data collection

Instrument used for collection of primary data was questionnaire. Questions were based on five parameters set according to SEBI guidelines of corporate governance. Secondary data was collected from annual reports of company and website on corporate governance.

### 2. Sample design and selection

The population consists of textile units which include spinning mills, hosiery units, readymade garment units and woolen mills. The sample size of 5 units were taken:

1. Vardhman spinning mills limited, Ludhiana 2. JCT Ltd, Phagwara 3. Suraj Industry Ltd, Muktsar. 4. Himachal Fibres Ltd, Solan 5. Arihant Spinning mills Ltd, Malerkotla

### 3. Research framework

As mentioned above, the instrument used for collection of the primary data was questionnaire. The framework of questions was according to objectives of study. There were basically six parameters chosen according to SEBI guidelines and under these parameters, different queries were made to study corporate governance practices followed by companies. Questions were based on parameters like composition of board of directors, independent directors, audit committee, frequency of meeting, function of various committee, board procedures, function of management, shareholder right. All these parameters are listed below: -

## **Board of Directors (BOD): -**

Main parameters were asked as follows: -

1. The board attitude and manner, which translates in awareness and understanding of its responsibilities.
2. Board of directors review company policies and strategies.
3. Board of directors overseeing major capital expenditures, acquisitions and diversifications.
4. Board of directors control change in financials.
5. Board of director oversees process of communications.
6. Evaluation of performance of management, CEO and executive director:
7. Board of directors does risk identification.

## **Audit Committee**

Queries regarding functions of committees are as follows: -

1. Audit committee suggestion and recommendation for improvement of: -
2. Internal control system and procedures
3. The companies by various segment with policies, plans and procedures by company.
4. Following audit is conducted:  
(I) Accounts audit (II) Purchase and store audit (III) Human resource audit
5. Audit committee reviews the reports of cost and internal audit department as well as auditors report on financial statement and how they recommend to the board to decide and see clarification thereon if required from auditors.
6. Can audit committee act as link between the statutory, internal and cost auditors and board of directors.

## **Board procedures**

Main points asked under this parameter are:

1. The ratio of executive and non-executive director in the board
2. Personal characteristics and core competencies required for selection of director
3. Every non-executive director gives sufficient time and attention to affairs of the company.
4. Does board of co. have a diversity of background, knowledge and experience?
5. Do the Board of directors know how to read balance sheet, project & loss account, cash flow statements and knowledge of company laws.
6. Directors have freedom to have leave integrality and independence of thought, the courage to express their independent thought, a grasp of realities of the business operations and understanding of the changes taking place.

## **Management**

1. Management assists the board in its decision making process in respect of company strategy and policies.
2. Management manages day to day affairs of company to achieve the target set by board.
3. Management provides timely, accurate and material information including financial matters to the board and shareholders.
4. Management ensures timely and effective service to shareholders.

## **Shareholders**

1. Company provides following information to shareholders:  
A brief review of directors, nature of his expertise and specific functional area, name of the companies in which the director is holding directorship.
2. Rights to shareholders are protected like: transfer and registration of shares, obtaining relevant information of the company on timely and regular basis, information like quarterly results, presentation made by companies.

## **Shareholders grievance committee**

Grievance committee focuses the attention of the company on shareholders grievances and sensitizes the management to redress their complaints.

1. Functions of grievance committee and meetings and members in committee
2. Specifically look into the redressing of shareholders complaints like:  
I) Transfer of share II) Non receipt of share III) Non receipt of declared dividends

## **Remuneration committee**

Main points discussed in this committee are remuneration package, pension rights, compensation rights and frequency of meeting and functions of committee.

Since our study is based on qualitative data, so no quantitative techniques have been used. There were basically six

parameters chosen according to SEBI guidelines and under these parameters, different queries were made to study corporate governance practices followed by companies. Questions were based on parameters like composition of board of directors, independent direction audit committee, Board procedures, management, shareholders, shareholders grievance committee, remuneration committee. These parameters are used as techniques to study the corporate governance practices followed by companies.

## **OBJECTIVES OF STUDY**

The objectives of study are as follows: -

1. To study the compliance governance practices as directed by SEBI.
2. To study the ethical conduct in business.
3. To ensure that directors of a company are subject to their duties, obligations and responsibilities.
4. To study whether textile industry are following provisions of corporate governance under listing agreement (clause 49).
5. To study the effects of good corporate governance.
6. To study the transparency that has been shown by industry while preparing annual reports.

## **FINDINGS AND SUGGESTIONS**

This chapter presents brief summary of main findings of study. Certain suggestions have also been made.

### **FINDINGS**

Corporate Governance practices followed by five units i.e. Vardhman Spinning Mills Ltd., JCT Ltd., Suraj Industry Ltd, Himachal Fibres Ltd., Arihant Spinning Mills Ltd have been studied. Findings are given below:

1. The report on corporate governance of five units show that out of five units three units i.e. Vardhman Spinning Mills Ltd., JCT Ltd, Suraj Industry Ltd are complied with the conditions of corporate governance as stipulated in the listing agreement clause 49 but Arihant Spinning Mills Ltd and Himachal fibres Ltd are not following the conditions of corporate governance as stipulated in the listing agreement clause 49
2. The report on corporate governance of Vardhman Spinning Mills Ltd, JCT Ltd, Suraj Industry Ltd, Himachal Fibres Ltd. shows that companies meets its obligations and fulfill its responsibilities to community, customers, employees, government and other segments of society but the annual report of Arihant Spinning Mills Ltd does not show the information regarding the duties and responsibilities discharged by the company.
3. Three units i.e. Vardhman Spinning Mills Ltd, JCT Ltd, Suraj Industry Ltd. are committed on adopting the best practices of corporate governance as manifested in the company's functioning to achieve the business excellence by enhancing long term shareholder's value. But annual reports of Himachal Fibres Ltd and Arihant Mills Ltd do not show information regarding company's functioning to achieve the business excellence by enhancing long term shareholder's value.
4. Efficient conduct of business of Vardhman Spinning Mills Ltd, JCT Ltd, Suraj Industry through commitment to transparency and business ethics in discharging their corporate responsibilities are hallmarks of the best practices followed by these units. But Arihant spinning Mills Ltd, Himachal Fibres Ltd. does not show the information regarding transparency and business ethics in discharging their corporate social responsibility.
5. Corporate Governance policies of Vardhman spinning mills Ltd, JCT Ltd, Suraj Industry Ltd. recognizes the accountability of the board and importance of its decisions to all our consultants including investors, employees banpee's etc. But annual reports of 'Arihant Spinning Mills Ltd, Himachal Fibres Ltd. do not recognizes the accountability of the board and importance of in decision to our consultants including investors employers, banker's etc.
6. Report on corporate Governance of Vardhman Spinning Mills Ltd. JCT Ltd. Suraj Industry Ltd. show that board meetings are held according to corporate Governance practices contained in Corporate Governance clause of the listing agreement. But Arihant spinning mills Ltd. and Himachal Fibres Ltd do not show the information regarding board meetings.
7. Report on corporate governance of Vardhman Spinning Mills Ltd, JCT Ltd, Suraj Industry Ltd. show that meetings of Audit Committee are held according to corporate Governance practices contained in corporate Governance clause of listing agreement. But Arihant spinning Mills Ltd and Himachal Fibres Ltd do not Show the information regarding meeting of audit committee.
8. Report on corporate Governance of Vardhman Spinning Mills Ltd, JCT Ltd, Suraj Industry Ltd. show that disclosures have been made by management to the board relating to all material, financial and commercial transaction but report on corporate Governance of Arihant spinning mills Ltd and Himachal fibres Ltd. have not made any discourses regarding material, financial and commercial transactions.
9. Compliance certificate from auditors of Vardhamn Spinning Mills Ltd., JCT Ltd, Suraj Industry Ltd certify that company has complied with the conditions of corporate governance as stipulated in the above listing agreement.

## SUGGESTIONS

Certain suggestions have been made which are as follows:

1. It is suggested that Arihant spinning Mills Ltd and Himachal Fibres should include in its annual reports information regarding its obligations and responsibilities to community, customers, employees, Government and other segments of society.
2. Arihant Spinning Mills Ltd, Himachal Fibres Ltd should include in three annual reports regarding their functionary to achieve the business excellence by enhancing long-term share holder's value.
3. Arihant spinning Mills Ltd, Himachal Fibres Ltd. should include in the annual reports the information regarding transparency and business ethics in discharging their corporate social responsibilities.
4. Arihant Spinning Mills Ltd and Himachal Fibres Ltd should make the discourses in annual reports regarding material, financial and commercial transactions.
5. Arihant spinning mills Ltd and Himachal Fibres Ltd should provide the information regarding transparency and business ethics in discharging corporate social responsibilities.
6. Arihant spinning Mills Ltd and Himachal Fibres Ltd should include the information in their annual reports regarding meetings of audit committee and board meetings.
7. Arihant Spinning Mills Ltd and Himachal Fibres Ltd. should include the certificates from auditors in their annual reports that certify the conditions of corporate governance as stipulated in the listing agreement Clause 49.

## CONCLUSION

The corporations have realized that management without good governance practices is like a ship without a sail. Good Governance is integral to the very existence of a company. Our study aimed to find out the Corporate Governance practices followed by Textile Industry. From Findings, we concluded that five units which we selected for our study, Vardhman Spinning Mills Ltd., JCT Limited, Suraj Industry Limited comply with the conditions of Corporate Governance as Stipulated in the listing agreement clause 49 but Arihant Spinning Mills Ltd. and Himachal Fibres Ltd are not following the conditions of Corporate Governance as stipulated in the listing agreement Clause 49.

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