

Irani Committee Report and Corporate Governance - a Flawed Theory

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The Irani Committee report reflects on the hard work done by several people. However, it builds on a flawed premise and the premise is so fundamental that it colours the entire report at dozens of places. The flaw relates to the respective roles of the company law and securities laws and thus flows directly into the areas of corporate governance in both fields. To get a better idea of the issue, one must look at the historical division between corporate law and securities law.

When there was no SEBI, raising of capital from the public had to be regulated by someone and something. The Companies Act along with the Registrar of Companies and supplemented by the Controller of Capital Issues played a role. However, with an increasing dispersal of shareholders, management became more and more unaccountable to the actual owners of the company. Though this wide dispersal was noted in the US in the early 1930s by Berle and Means in their famous paper “The Modern Corporation and Private Property”, the equity culture was introduced in India only in the early 1980s with the growth of Reliance Industries. This dispersal of shareholders meant that an entirely different approach needed to be taken to build a bridge between the managers and owners of a widely held company. Such a bridge came in the form of modern securities regulations as distinct from company law. The twin bridge was composed of principles of disclosure and the rule against fraud. Thus managers were obliged to disclose fully to the shareholders and were to face liability if they lied. This requirement is of course not necessary where a company is relatively closely held and therefore the agency problem does not arise as ownership and control are closely aligned. A similar bridge was built in the US in 1933 and 1934 with the passing of their securities laws.

The Committee seeks to arrogate to the Ministry all powers relating to companies whether listed or not, whether raising capital from the public or from three family members based on an elusive concept of ‘public interest’ determined by the size or number of shareholders of a company. It makes a distinction between ‘internal governance’ which should not be gone into by the securities regulator and other matters, presumably ‘external governance’, which can be regulated by the securities regulator. Thus matters of corporate governance are handed down as fait accompli for all companies with ‘public interest’. It would be counter-productive to have corporate governance norms in unlisted companies. Imagine an audit committee and a remuneration committee in a 30 person ‘public’ limited company merely because it has a capital of 20 crores. It would be equally unfair to have the same norms for a company which is held by millions of shareholders. William Blake said several centuries back that one law for the lion and ox is oppression.

Though the report recognizes that different types of companies need different regulatory treatments, it refuses to demarcate powers between the Ministry and SEBI on the ground that there may be ‘public’ companies which need to be protected even if they are not listed and have not raised capital from the public. While the committee is silent on this elusive ‘public interest’, public interest stares us right in our face like Banquo’s ghost in Macbeth. Public interest can be attracted only when a company is widely held by unconnected people who have invested on the premise that they will have an additional protection of securities laws. When can a company be widely held? Though not a strict rule in theory, a company cannot be widely held unless an offer is made to over 50 persons - the basic requirement of a public offer. Similarly a company cannot be listed unless it is widely held - exchange rules ensure that. Thus the elusive ‘public interest’ which the Irani Committee is searching for is fairly clear cut and

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distinct - it is the listed company. Investors who invest capital in listed or about to be listed companies, do so on the assumption that the managers will be accountable to them and they will have the protections of corporate governance norms - norms which are specifically enacted to reduce of conflicts of interest in managers and directors. If a company is raising capital from a dozen persons with no possibility of listing, there cannot be any public interest because the person is obviously investing on a close relationship with the promoter/managers of the company, knowing fully well that there is virtually no liquidity in the shares of such 'public' company.

Also, the attempt to have uniform corporate governance standards for listed and unlisted companies is not a proper sequiter to the different character of listed versus unlisted companies. The difference is very pronounced - you cannot have the same corporate governance structure for a family controlled company as a widely held company. There is no public interest in setting standards in the former whereas there is a huge public interest in regulating conflicts in governance in the latter because of the separation of ownership from control in the latter.

Thus the increased protection which the committee is granting to unlisted companies - private or 'public' is an unnecessary nuisance for such companies. The nuisance is necessary only when ownership is so distant from control that the law must step in and make the managers accountable - a job cut out for clause 49 clearly.

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