

FINE TUNING INDIA INC. IN THE CHANGING BUSINESS ENVIRONMENT

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In retreat after the events of September 11, 2001, critics of globalization have now received a renewed shot in the arm. Investors continued to watch their portfolios plunge in the wake of corporate mischief sweeping world's major stock exchanges. Once high flying Companies such as Enron, Anderson, WorldCom, Xerox and Global Crossing Limited have all been battered by corporate scandals involving questionable accounting practices and misleading management.

Whether it's arm sales, banking rules or cetacean survival, the ABC's of world regulatory oversight are by no means clear. National or economic interests exert pressure for ill or for good, often making world commissions/ forums -whether they exist at all - ineffective and controversial.

Joseph Stiglitz, Nobel Prize winner in Economics, in his recently published book titled "*Globalization and its discontents*", has mentioned India only in passing remarks -as a country that, like China, escaped the ravages of the global economic crisis in the 1990s.

It can, however, be noticed that India has emerged as a success story of steady and robust growth. It was bailed out by the IMF (International Monetary Fund) in 1981 and 1991. In 1981, its response was an inward-looking adjustment that proved successful for a while but ultimately resulted in a economic collapse by the end of the decade. In 1991, the response was outward looking with a homegrown globalization strategy that has made the economy vastly more resilient. True, we are not China, especially in foreign trade and investment. But that is entirely because of ourselves -poor infrastructure, rigid labour laws and small-scale

reservation have prevented India from emerging as a world leader in labour intensive mass manufacturing. Even so, globalization has strengthened India immeasurably. It is reflected, for instance, in the visible rise in foreign exchange reserves that amounted to more than US\$60 Billion at last count.

However, globalization and the competitiveness have certain adverse effects also which can not be overlooked viz., increased unemployment rate, decreasing of manufacturing industry's base for want of funding sources thereof, non-availability of risk capital, capital market being at its lowest ebb, huge NPAs in financial sector, etc.

The removal of barriers to free trade and closer integration of world economies can be a force for universal good. True, the Doha Ministerial has shown some signs of developing countries having their say in negotiations. Yet the regulatory framework fall short of desired strength. There seems a need for a new approach to the governance of globalization. On this transformation from the rocky road to global governance, India can lead the way here.

Regulatory Response

The government has with great deal of commitment continued the reform process in the corporate sector. Major regulatory alignments have been made in the areas of corporate governance, investor relations, labour reforms, finance sector reforms and, last but not the least, in the international trade to fine-tune the Indian laws in the WTO regime. Some such major regulatory alignments and their effect have been discussed in the following paragraphs.

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Corporate Governance – Making a Difference

The concept of Corporate Governance has been given a renewed statutory form. A series of amendments have been brought to the statute book of late, major being the Companies (Second Amendment) Act, 2000 which was passed with the following objectives:

1. To provide certain measures for evolving good corporate governance;
2. To provide measures for investor protection;
3. To make certain important changes in the Companies Act that cannot wait till the Companies Bill, 1997 is enacted into law.

Subsequently, there have been series of amendments introduced by the Govt. of India, Department of Company Affairs (DCA) from time to time, steps towards attainment of the objective of ensuring greater corporate governance. Major amendments in the Companies Act, 1956 in this direction include appointment of independent directors on the Board, concept of postal ballot, constitution of audit committee, amendment in the provisions relating to managerial remuneration as stated in Schedule XIII (vide notification dated 16/1/2002), constitution of remuneration committee, amendment relating to Directors' disqualifications, and so on.

More prominently, making of various Accounting Standards mandatory on the part of corporate under Section 211(3C) and also the Directors' responsibility statement under Section 217(2AA) on the accounting practices followed/ policies adhered, have been landmark amendments in this direction.

As the reform process continues, a number of measures are under active consideration such as reforms in insolvency laws and winding up of companies, synchronization of company law with Information Technology Act, holding of board meetings through video and teleconferencing, etc.

For listed companies, the Securities and Exchange Board of India (SEBI) has made it mandatory through listing agreement, to follow the corporate governance code. On 20/2/2002, to curb the possibility of insider trading as also to enthrone the investor's confidence, the SEBI has comprehensively amended SEBI (Prohibition of Insider Trading) Regulations, 1992.

In line with the recommendations made by the working group on corporate governance, the government is considering to step up the statutory disclosures requirements for companies which raise loans from financial institutions (FIs) and banks as well as those that place equity with FIs (regardless of whether they are listed or not) –at par with listed companies.

The rationale behind the proposal is that such companies involve indirect public interest. Besides, there is no reason why the benefit of limited liability for these companies should come for free –the companies can pay for the benefit with greater disclosures. These recommendations are expected to find favour with the DCA, which is set to refresh norms for India Inc., as considerable public interest is generated by companies that tap FIs and banks for funds.

The concept of corporate social responsibility has become an inevitable phenomenon. Be it minimizing environmental damage or increasing community involvement, demonstrating "Social Responsibility" is recognized as one of the key means of attaining corporate governance, by organizations globally. Large companies are playing key roles in community development programs to demonstrate their socially aware and responsible behaviour.

Investor Relations – Making things Better, or Late

"The greater our knowledge increases the more our ignorance unfolds" –John F Kennedy's quote holds true in today's corporate world as well.

Relationships between companies and their customers, employees, suppliers, and the general public have been undergoing revolutionary and sometimes planned development for many years – though usually long after the need has arisen. A few decades back, most employers gave employees a pay envelop every month and thought, "That's that". Today we know a lot more, and the employers do a lot more for our employees, but until recently most companies treated shareholders about the same way they formerly treated their employees.

Only in the last ten years or so, has management's concern for the shareholders' interests increased sharply. This can largely be attributed to the evolution and development of the concept of "Corporate Governance" of late and, to some extent, to the "Regulators" for making it mandatory on the

part of public/listed companies to have some sort of Governance code to follow. Shareholders and outside investor public have not always received as much attention and policy consideration as have other groups. Although the investor of today may not be the completely forgotten man once he was, he is far from receiving sufficient public recognition for his contribution.

Among the factors behind the neglect of investor relations are three major roadblocks that impede progress even after management has decided on a policy of planned development. The greatest single hindrance is the relatively low "visibility" of shareholders and outside investor public. Most other groups, employees for example, are highly vocal, and some are highly organized. It requires attentive management to hear the shareholders amid the clamor and the incessant urgency of the issues raised by these other groups.

The second major roadblock is an oppressive political and social climate of opinion dating back to the stock market crash of year 1992. The legislation that was enacted after the crash reflected a prevailing attitude of distrust and bitterness towards securities and everybody connected with them. The distrust and bitterness have largely, though not entirely, abated; but the laws and Boards/Commissions linger on and help to sustain the still burdensome climate that affects the outlook of management, the interests of shareholders, and the attitudes of the investing and potentially investing public, more particularly the attitude towards equity investment.

The third hindrance is inadequate management orientation toward shareholder's interests. Some managers have treated their shareholders as though they were wholly outside the Company and not very important to the success. This temptation to overlook the interest of shareholders has been aptly described in the following words (by H. G. Wells): "It is a universal weakness of mankind that what we are given to administer, we presently imagine that we own."

Though the reforms initiated in the securities laws and capital markets encompass a wide range of issues, yet the need of the hour is to continue to bring about further transformation and improvements in the regulatory framework and infrastructure to ensure that the securities laws remain responsive to the changing global market requirements. This would also help to bring back

the confidence of the small investors in the capital markets which has somewhat lost in the wake of successive recurrence of scams, increasing instances of corporate failures, vanishing companies (fly by night operators), questionable accounting practices and misleading management by corporate, etc.

Labour Reforms – Much Hype Less Work

In the Union Budget 2001, the thrust was on ending the rigidities in the labour laws. The government has so far neither displayed the will nor commitment to pursue this agenda – perhaps in the wake the opposition mounted by successive labour ministers and the trade unions to this move.

The Second Labour Commission's report has suggested some interesting leads by taking middle path on issues like contract labour and the amendment of Industrial Disputes Act. As such, the proposed bill seeks to improve the working conditions of the contract labour and on the face of it, even restricts Companies from outsourcing certain services and employing contract labour to carry out certain core activities. The contract labour will be entitled to remuneration on par with the regular employees, apart from social security and other benefits. It is proposed to provide insurance cover to contract labour against accidents, illness, death and short-term unemployment. Additional cost on this count will have to be borne by the Companies.

The move to amend the Contract Labour (Regulation of Employment and Condition of Services) Act, which prevents companies from using casual, unprotected workers for regular work of perennial nature and from farming out production to sweatshops, had raised a political storm.

On labour reforms, much hype has been created. The corporates always feel frustrated and harassed in the name of labour reforms. On one hand, the flexibility need be built in the system to allow corporate function without much frustration and on the other hand security and stability aspect need be addressed appropriately to safeguard labour interests.

The Securitisation of Ordinance 2002 – A Hasty Decision

A recent Ordinance giving unprecedented powers to banks and similar institutions to recover debts could well spell a death knell for many companies struggling to remain afloat in adverse business conditions. The Securitisation and Reconstruction

of Financial Assets and Enforcement of Security Interest Ordinance, 2002 has endowed banks, financial institutions, asset reconstruction and securitisation companies with powers that step all normal legal procedures. These entities can now take over management of a company that defaults on its loan payments or take possession of its assets, under police escort, if necessary. Even worse, no court can entertain any appeal against these actions.

These are by any standard draconian measures that ignore basic tenets of business law. Leaving aside a few willful defaulters, it is never a case that companies borrow to eventually default on their debt repayment. In fact, most companies go to extremes to secure high credit ratings to enable them to borrow at favorable terms and grow. The credit rating agencies exist precisely to rate the repayment capabilities of companies. More so, the prudent lenders go a step further and take pains to make sure they are lending to companies with right credentials.

Indeed, it is a universally recognized principle that at the end of all this procedure if things go sour, it is simply a case of bad luck, which may, in most cases, be just a temporary phase. Most civilized governments recognize the fact that there are ups and downs in businesses and provide enough safeguards against any hasty action by lenders. In the US, companies even have recourse to Chapter XI filings.

But the present Ordinance, which will soon become an Act*, gives unprecedented powers to the lenders that are easily open to misuse. They can now bypass the BIFR filing. Meaning thereby, even if there is a legitimate case for financial restructuring, lenders in their zeal to clean up their balance sheet can spike the proposal. The fact that the lenders can take possession of the securities in case of default and sell them without having to turn to Courts is, perhaps, the most unfortunate aspect of the Ordinance. It amounts to a complete lack of confidence and trust in the working of Courts by, no less an entity, than the Indian Government. This would undermine the confidence of the Indian and International public in the capacity of Indian Courts to dispense justice in the civil suits.

There is no doubt that banks' NPAs have reached alarming proportions. But past experience

has shown that draconian measures with laudable objectives, whether for maintenance of internal security or for foreign exchange regulation or do deal with act of terrorism, have all led to misuse despite inbuilt safeguards. In contrast, this Ordinance has no safeguards. Instead of rectifying the tilt against lenders and evenly balancing the law between lender and borrower interests, the government has clearly taken a retrograde step that violates the basic principle of natural justice.

These concerns have somewhat been addressed by the Supreme Court in the very recent case of Mardia Chemicals (in October 2002) whereby the apex Court has prevented lenders from creating any third party claim on, or selling the, the borrowers' assets under the new legislation. With this, the defaulters have heaved a sigh of relief whereas the banks and the financial institutes feel that the Ordinance has been rendered ineffective.

True, it's nobody's case that banks and financial institutions need no recourse against debt defaults. But the drastic measures that ignore the legal channels are not the answer. The government should have the courage to spell out what is wrong with the present system. It can then take steps to rectify the problems, so that any one, not just financial institutions, who has to recover their monies legitimately owed to him can take recourse to the Courts rather than look for remedies outside the system.

Disinvestment — A Bumpy Ride Continued

Though the government has implemented with great commitment, disinvestments of some very large profitable public sector undertakings, yet on issues where the government was to deal with its allies, it has demonstrated lackluster political will. The decision on postponement of disinvestments of Hindustan Petroleum Corporation Limited (HPCL) and Bharat Petroleum Corporation Limited (BPCL) for three months in the wake of opposition from within the government is one such instance, which has not only lowered the pace of the disinvestments process but has also sent wrong signals amongst the investing community at large. In all probability, such flexi-approach might adversely affect the pricing, which is one of the most crucial factors and which

* The Ordinance issued on 21-6-2002 having expired, a Second Ordinance was issued on 21-08-2002. A Bill has already been introduced in the Lok Sabha on 19-07-2002.

has a direct nexus with the desired fruits of such disinvestments.

The success of the Maruti and Nalco public issues is important, as their outcome would determine the contours of future disinvestments programs. It could be crucial for decision on offloading shares to the public in strategic PSUs such as ONGC, Indian Oil Corporation, Gas Authority of India and NTPC.

However, on the regulatory front, SEBI has changed rules to make disinvestments via book building a reality. The regulator has allowed three major concessions including introduction of safety net for retail subscribers of PSUs' public issues. One, hard underwriting will henceforth be allowed for 60-days from the date of listing/ commencement of trading of the shares on the stock exchange if scrip trades below the issue price. The underwriter of the issue would have to compulsorily buy the shares back at the pre-determined price if the retail subscriber wishes to exit the scrip.

Second, merchant bankers building books for companies would be allowed moveable price bands for acceptance of bids against fixed price bands as was seen in cases of the Bharti Televentures and i-Flex public issues.

And third, government book runners would be allowed to retain up to 10% of the over subscription against the existing norm of 5% for all Companies. The disinvestments ministry had sought a green shoe option of 15%, which is the international norm for public issues. An announcement on intention to retain over subscription would have to be made upfront.

The three concessions would definitely benefit the government's plan to offload 25% in Maruti Udyog Limited through book building process. Also, it might be used in the public issue of NALCO, which is expected early next year. With these amendments, the Disinvestment Ministry has some good reasons to expect that such flexibility would ensure that

public issue of shares would sail through even in a depressed market.

The government seems to be committed to carry its stride further with an objective that -Government should regulate business and not do the business itself (except of course, for the strategically important and sensitive sectors). The successful privatization of non-critical PSUs would pave way for better governance, improve the overall work environment, increase the confidence of investors, and over and above, would endorse the government's commitment in furthering its objective that -government should regulate the business rather doing the business itself.

Where Come and Where to Go

The reform process to align the Indian economy with that of global economy has although brought some good results but has not been able to bring all round development throughout the economy. The development and growth has by and large been concentrated in the urban centres, which has only 10-15% of the total population of the country. The Indian economic model needs to be revisited to ensure all round economic growth and has to provide due attention to all sector of the economy.

To spread the benefits of reforms to a larger spectrum, the government must continue with even greater commitment to create the right kind of regulatory framework, infrastructure and work environment to develop successful entrepreneurs. To do this, there is a need to focus on creating the right environment for success: Entrepreneurs should find it easy to start a business. On the other hand, every business manager has constantly to be on his toes to grab the opportunity to learn, update, plan ahead, and effectively manage the change and the challenges ahead. This is the only way to exist and flourish in the business. All this would not only bring widespread economic growth but also the standard of living of the ultimate consumer, the common man could go up substantially.