



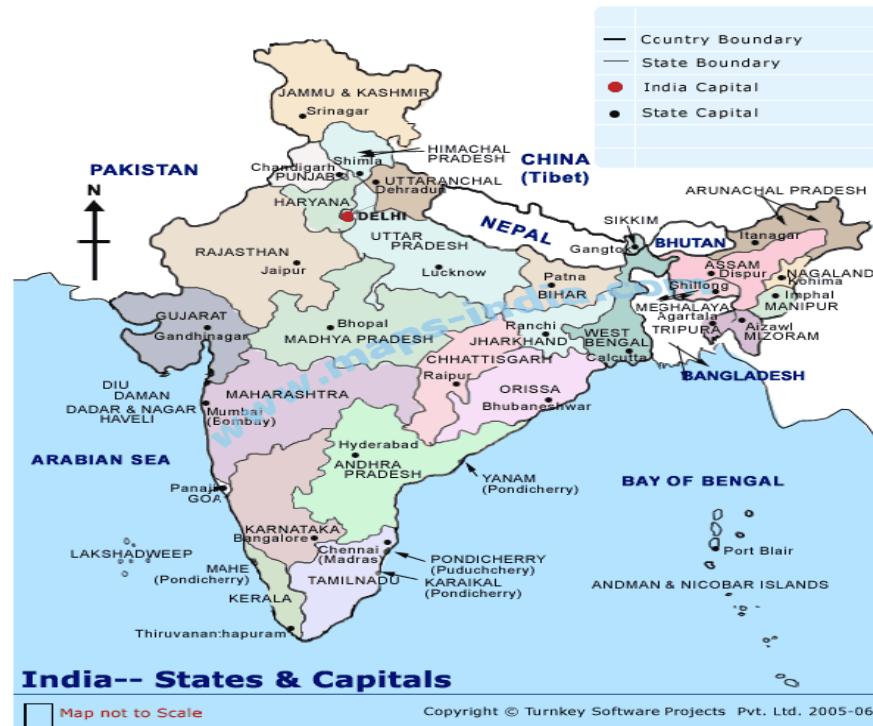
India and U.S. Markets Compared: Sarbanes-Oxley Act's Affect on Other Countries

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General Information About India

- Population of India is estimated at 1.1 billion people, over 15% of the world's population. Only China has a larger population.
- Nearly 3 times the population size of the U.S., however only 1/3 the size geographically.
- Includes 28 states, 7 union territories and the National Capitol Territory (Delhi)
- Branches of Government: *Executive*--president (chief of state), prime minister (head of government), Council of Ministers (cabinet). *Legislative*--bicameral parliament (Rajya Sabha or Council of States, and Lok Sabha or House of the People). *Judicial*--Supreme Court.



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- According to its Constitution, India is a "[sovereign, socialist, secular, democratic republic](#)." Like the United States, India has a federal form of government. However, the central government in India has greater power in relation to its states, and has adopted a British-style parliamentary system.
 - Real [national executive power is centered in the Council of Ministers](#) (Cabinet), led by the prime minister.
 - India's [independent judicial system began under the British](#), and its concepts and procedures resemble those of Anglo-Saxon countries. The Supreme Court consists of a chief justice and 25 other justices, all appointed by the president on the advice of the prime minister.
 - The central government exerts greater control over the union territories than over the states, although [some territories have gained more power](#) to administer their own affairs.
 - It has the [world's 12th largest economy](#)--and the third largest in Asia behind Japan and China--with total GDP of around \$691 billion.
 - India is continuing to move forward with market-oriented economic reforms that began in 1991. Recent reforms include liberalized foreign investment and exchange regimes, industrial decontrol, significant reductions in tariffs and other trade barriers, reform and modernization of the financial sector, significant adjustments in government monetary and fiscal policies, and safeguarding intellectual property rights.
 - The [United States is India's largest trading partner](#). Bilateral trade in 2004 was \$21.7 billion.
 - The United States is India's largest investment partner, with a 17% share.
 - In late September 2001, President Bush lifted the sanctions that were imposed under the terms of the 1994 Nuclear Proliferation Prevention Act following India's nuclear tests in May 1998.



U.S. Outsourcing: Trends and Statistics Involving India

India Still #1 Outsourcing Haven

- In 2005 the total value of outsourcing to India was estimated at \$17.2 billion or 44 percent of the worldwide total, according to a report from India's National Association of Software and Service Companies (NASSCOM).
- NASSCOM also stated about 80 percent of the *Fortune* 500 companies outsourced at least one operation to India in 2004, compared with 60 percent in 2003.
- NASSCOM Chairman S. Ramadorai expects India's market share to expand to 51 percent by March 2008.
- The Associated Press has reported that the hourly rate for software development workers ranges between \$18 and \$26 in India, compared with \$55 to \$65 per hour in the United States and Europe.

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- According to the Associated Press, [India's biggest outsourcing competitors](#) (as of 2005):



Canada (32 percent market share)



China (4.9 percent)



Eastern European countries (4.5 percent)

- India is becoming a strong base for [software development](#) and the [outsourcing of services](#) and manufacturing. But the executives concluded in their report that greater United States investment could help the further development of India's infrastructure, and more American technical expertise could help upgrade its low-cost manufacturing.

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- In October 2005, [Cisco Systems](#) said it would invest [\\$1.16 billion](#) in India, tripling its work force here, and companies like [Intel](#) and [Microsoft](#) swiftly followed with commitments of their own.
 - The chief executive of Cisco, the world's largest computer networking manufacturer, has said that [India has the potential to become its biggest market in Asia in five years](#).
 - Chief executives such as from Infosys Technologies, one of India's largest outsourcing companies, participated in a March [2006 C.E.O. Forum](#) initiative organized by President Bush, which demonstrated an acknowledgment that Indian and U.S. businesses are catalysts for a close relationship between the two countries.



Summary of the History of Corporate Law in India

Colonial History of India

- European presence in India dates to the [seventeenth century](#).
- In [1600](#) Queen Elizabeth I of Great Britain granted a royal charter to the [East India Company](#).
- In [1617](#) the British were given permission by India's ruling government to establish a British presence in India.
- In [1757](#) the British won a battle which led to creation of the East India Company and transformed from an association of traders to rulers exercising political sovereignty over a largely unknown land and people.
- During [1857-58](#) the [Indian Rebellion](#) began. The city of New Delhi was lost by the British, but ultimately regained and the rebellion was defeated. As a result of the Rebellion, the East India Company was abolished and [India officially became a Crown](#) colony of the British. From then on India was governed directly by the British Parliament, led by a member of the British cabinet, the Secretary of State for India.

Colonial History of India, Continued

- In the late 1800s, the first steps were taken toward self-government in British India with the appointment of Indian councilors to advise the British Viceroy and the establishment of Provincial Councils with Indian members; the British subsequently widened participation in Legislative Councils. Beginning in 1920, Indian leader Mohandas K. Gandhi transformed the Indian National Congress political party into a mass movement to campaign against British colonial rule.
- After World War I, despite British promises of more self-rule more draconian rules were introduced. This, amid massacres of Indians, led to the rise of Gandhi in 1919.
- Gandhi led a non-cooperation (civil protest) movement against the British in 1920-22, as well as a campaign of civil disobedience in 1930-31. In 1937, the British government agreed for the first time to grant political autonomy to India. In 1942 Gandhi issued a call to the British to “Quit India.”
- In the aftermath of World War II, the British finally granted India its independence on August 15, 1947. However, the British partitioned British India into two separate states: India, with a Hindu majority; and Pakistan.

History of Corporate Development in Pre-Independence and Post-Colonial (Modern) India

- Before India's independence from Britain, much of India's industrial development was restricted by British economic policies.
- In 1950-51, there were individuals who held multiple directorships and extensive interlocking directorships among both Indian and British firms.
- Study conducted indicated 9 leading Indian industrial families held nearly 600 directorships or partnerships in Indian industry.
- First real occasion for reform came in 1908 with passage of Companies (Consolidated) Act.
- In 1913 a new bill was introduced, but not passed, which tried to address the issue of Agent Manager abuse. Initial plan sought to require all firms to have boards where managing agents were in the minority. Despite this type of law passing in Britain in 1908, it was watered down and failed to pass.
- Companies Act's managing system problems were addressed in reform in 1936. However, it still left many loopholes.
- In 1946 an investigation was commissioned to propose the lines along which the Companies Act should be revised.
- Following the recommendations of the Company Law Committee formed in 1950, the Companies Act was passed in 1956 with the goal to amend and consolidate laws relating to companies and certain other associations. The new act repealed the Companies Act passed in 1913.
- The Companies Act, 1956, has been amended as many as 24 times since 1956.

History of Corporate Development in Pre-Independence and Post-Colonial (Modern) India, Continued

- Major amendments were made in [1988](#), [2002](#)
- The Companies Act, 1956, is designed in order to promote a simplified compact of Law that may address changes national and international scenarios, to enable adoption of internationally accepted best practices while providing flexibility for evolution of new reforms as needed.
- With a view to improve the standards in corporate governance the Ministry of Company Affairs, which enforces the Companies Act for all of India, with Industry Associations and professional institutes, set up the [National Foundation for Corporate Governance](#) (NFCG) as a not-for-profit trust in [January 2003](#).
- The Ministry introduced a Companies (Amendment) Bill in 2003 containing important provisions in the area of
 - independence of auditors
 - relationship of auditors with the management of the company
 - independent directors with a view to improve the corporate governance practices in the corporate sector.
- In [2003](#), after the above amendment, the Government proposed more changes to law and began to draft many recommendations. This movement was influenced by corporate governance reforms such as Sarbanes Oxley Act in response to Enron and World Com scandals in the U.S.

History of Corporate Development in Pre-Independence and Post-Colonial (Modern) India, Continued

- In 2004 the Government of India published a Concept Paper on Company Law (what U.S. regulatory agencies would call a proposal for new regulation and comment) which would consolidate the existing provisions of the law, especially the above objectives.
- The aim of this [Concept Paper](#) was to enable critical examination of the provisions, including:
 - Formation of company and other organizational matters
 - Accounts and Audit
 - Management of the company
 - Powers of *Central Government* to carry out inspection and investigation of companies
 - Reorganization of companies by merger, consolidation, etc.
 - Winding up companies
 - Other business entities which may register
 - Producer Companies, a separate class of companies
 - Foreign companies, offenses and penalties and other miscellaneous provisions

Current Corporation Law in India

- Corporations (as well as other business entities) are regulated by the [central government of India](#).
- [Memorandum and Articles of Association](#) by the solicitors (lawyers), vetting of the same by registration of company, signed by at least two subscribers in his/her own hand, his/her father's name, occupation, address and the number of shares subscribed for and witnessed by at least one person. Additionally, provide:
 - Declaration of compliance
 - Notice of situation of registered office of the company
 - Particulars of the Director's, Manager or Secretary
- After these [forms](#) are processed and complete, Corporate Identity is generated, a Certificate of Incorporation is obtained.

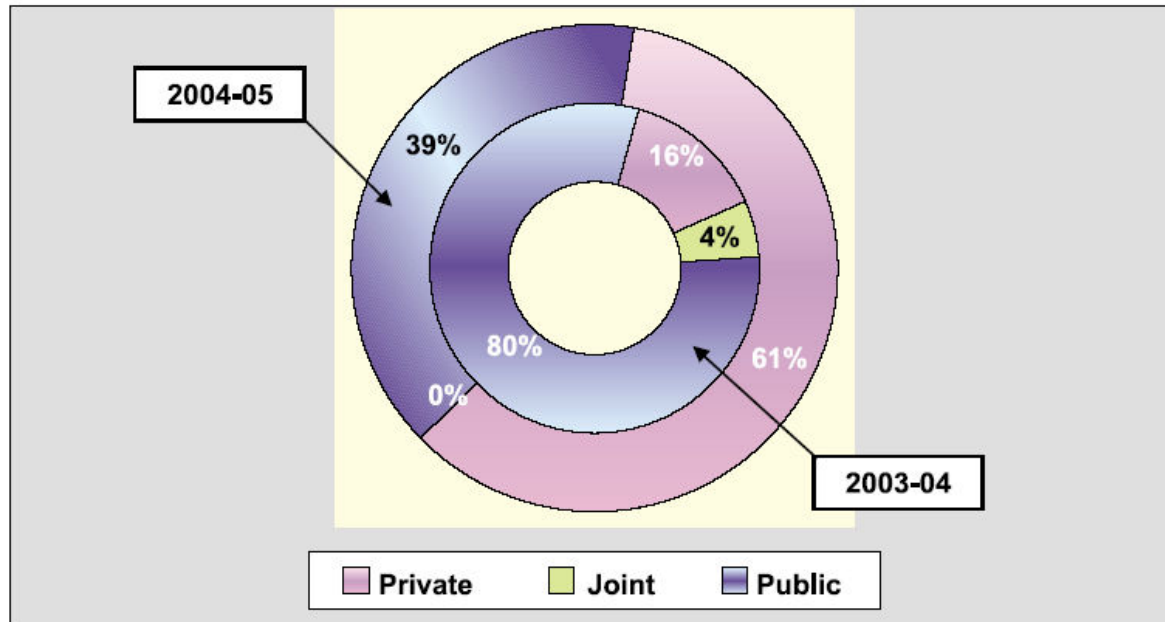
- **Additional steps to be taken for formation of a **Public Limited Company**:**


To obtain Commencement of Business Certificate after incorporation of the company, the public company has to make the following compliance:

- File a declaration in eForm 20 and attach the statement in lieu of the prospectus (schedule III) OR
 - File a declaration in eForm 19 and attach the prospectus (Schedule II) to it.
 - Obtain the Certificate of Commencement of Business.
- **Shareholder Voting Rights.** According to Indian rules and regulations, all shareholders have the right to participate and vote at general meetings.
 - In India, **acquisition of more than 15 percent of shares** or voting rights requires the acquirer to make a public stock offering.
 - To approve a **merger** regulations require a shareholder vote of 75 percent.


Current Corporation Law in India, Continued


- Companies Act requires that an **Annual General Meeting (AGM)** be held every year, and that a notice convening the meeting be sent to all shareholders at least 21 days in advance of the meeting. In addition to the AGM, the Companies Act allows for shareholders controlling 10 percent of voting rights or paid-up capital to call a special or **Extraordinary General Meeting (EGM)**





Summary of U.S. Corporate Law Regarding Sarbanes-Oxley


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- Major innovations of the SOX was creation of a [Public Company Accounting Oversight Board](#) to oversee audits of public companies subject to U.S. securities laws, to protect investment interests, and to develop public interest in the preparation of informative, accurate, and independent reports.
 - [Section 301](#) of the Act requires companies listed on U.S. Stock Exchanges to have an [audit committee](#) comprised [solely of independent directors](#). Requirements for independent directors include:
 - Not to accept any consulting, advisory, or other compensatory fee from the company, OR
 - Not to be an affiliated person of the company or any subsidiary thereof
 - [Section 302](#) requires the CEO and CFO of a public company, as well as any officer also signing, in each quarterly and annual report that they submit that they [guarantee the accuracy of the report](#) and to certify the accuracy of the company's financial statement, and that the company has adopted adequate internal controls.
 - [Section 305](#) expands the SEC's [ability to remove directors and officers](#) and bar them from serving in similar capacities at other public companies by demonstrating their "unfitness".
 - SOX does not define what [unfitness](#) is and the legislative history of the Act provides no guidance either. The prior standard required "substantial unfitness". This affects both the Securities Act of 1933 and the Securities and Exchange Act of 1934.

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- **Section 402** bars public companies from directly or indirectly making any loans to directors or officers. Loans have been discretionarily used by corporate directors and officers in public corporations, before SOX.
 - The only exception is for loans made in ordinary course of business,
 - Of a type that is generally made available by such issuer to the public; and
 - Made by such issuer on market terms, or terms that are no more favorable than those offered by the issuer to the general public for such extensions of credit.

 - **Section 404 Costs:** The 2005 Oversight Systems Financial Executive Report on SOX surveyed more than 200 financial executives and found a significant majority believe that, after implementing requirements to remedy control deficiencies, they have seen bottom-line business benefits. Nearly half said SOX compliance resulted in reduced risk of fraud and errors, and they now have more efficient operations. In a 2005 Ernst & Young survey, 87% of respondents noted enhanced accountability and ownership of controls as areas of added value provided by SOX.

 - According to **former SEC Chairman Pitt**: “Unfortunately, that doesn’t change the fact that the costs of these improvements are thought by many businessmen and businesswomen to outweigh the benefits. SOX has certainly and substantially increased corporate-compliance costs. AMR Research estimates that companies will spend \$6 billion to comply with SOX in 2006, on a par with the amount spent in 2005. Corporate executives have railed against the excessive costs of implementing SOX, threatening delisting, abandonment of America for Europe, and the end of America’s capital markets.”

 - **Section 406** requires that a public company disclose under the SEC’s Securities Exchange Act Rules if a code of ethics has been adopted for senior financial officers or an explanation of its failure to adopt such a code.

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- **Section 906** provides stiff criminal penalties for CEOs and CFOs who fail to comply with financial certification requirements such as listed in section 302, as follows:
 - Whoever certifies a financial statement knowing that it does not comply with SOX Requirements shall be fined not more than \$1 million or imprisoned not more than 10 years or both.
 - Whoever willfully certifies any statement that does not comply with SOX Requirements shall be fined not more than \$5 million or imprisoned not more than 20 years or both.
 - According to the President & CEO of the NASDAQ Stock Exchange, "SOX has had the unintended consequence of triggering a **"race to the bottom"** by stock markets and companies seeking advantage via less jeopardy, less regulation, less cost and less hassle."
 - **How to Reform SOX?** The SEC's Advisory Committee on Smaller Public Companies has proposed an exemption from Section 404 for
 - Companies with *less than \$128 million* in market cap and revenues under \$125 million.
 - Companies with *up to \$787 million* in market cap, as long as they had revenues *less than \$250 million*, would receive partial exemption.
 - The companies exempted would account for only *6% of U.S. market cap*, which means 404 would still apply fully to 94% of equity market capitalization.



Summary of India's Corporate Law
Version
of
“Sarbanes-Oxley” and related
provisions

“Is Indian Business Ready for a Brave New World of Tough Corporate Governance?”

- India has two places in its legal system where a “Sarbanes-Oxley” (SOX) type of law appears:
 - (1) *Companies Act* and
 - (2) *Clause 49*, a regulation for listed companies made by India’s securities exchange commission, the *Securities and Exchange Board of India (SEBI)*.
- In *2002*, SEBI updated its listing requirements with *Clause 49*, which has mandatory and non-mandatory corporate governance provisions. These listing requirements were again changed in *2004* to incorporate some best practices laid out in SOX.
- *Ministry of Company Affairs* is responsible for enforcing all SOX-type laws which fall under its purview.
- As global business interest in India keeps growing, so does the expectation that Indian companies must play -- and be seen to play -- by rules that are clear to international investors. Demands have long been heard for greater transparency in the way Indian companies do business. Now, matters are about to come to a head. Ready or not, India's public companies must meet a *January 1, 2006*, deadline to comply with sweeping new corporate governance standards.
- India has *22 recognized stock exchanges*, the two most important being the *Bombay Stock Exchange Limited (BSE)* and the *National Stock Exchange of India Limited (NSE)*.

Fundamental Characteristics of India's SOX Laws: Board of Directors

- SEBI's Clause 49 includes a definition of board independence—that at least **one-third of the board be non-executive** and that a majority of these be independent.
- Clause 49 goes further to require that in cases where the chairman of the board is an executive, 50 percent of the board be comprised of independent directors. However, despite the requirement for board independence, the availability of trained independent directors in India is limited.
- Clause 49 states that the **board should meet at least four times a year**, with a minimum time gap of three months between any two meetings.
- However the *Companies Act*, on the other hand, only **requires that 33 percent of board members or two members, whichever is greater, be present**. There is no provision that specifies whether non-executive or independent members need be present.
- In India, every board is required to have a **shareholder grievance committee** and an **audit committee**.
- Clause 49 also requires that **listed companies** begin disclosing their corporate governance practices in the Annual Report to shareholders. Moreover, companies are required to provide on their *website information* such as quarterly results and presentations made to analysts. Companies that do not have their own website have to send this information to the stock exchange on which they are listed so that the stock exchange can put it on its website.
- Clause 49 requires listed companies to **inform board members about risk assessments and risk minimization** procedures in the company.

Fundamental Characteristics of India's SOX Laws: Board of Directors

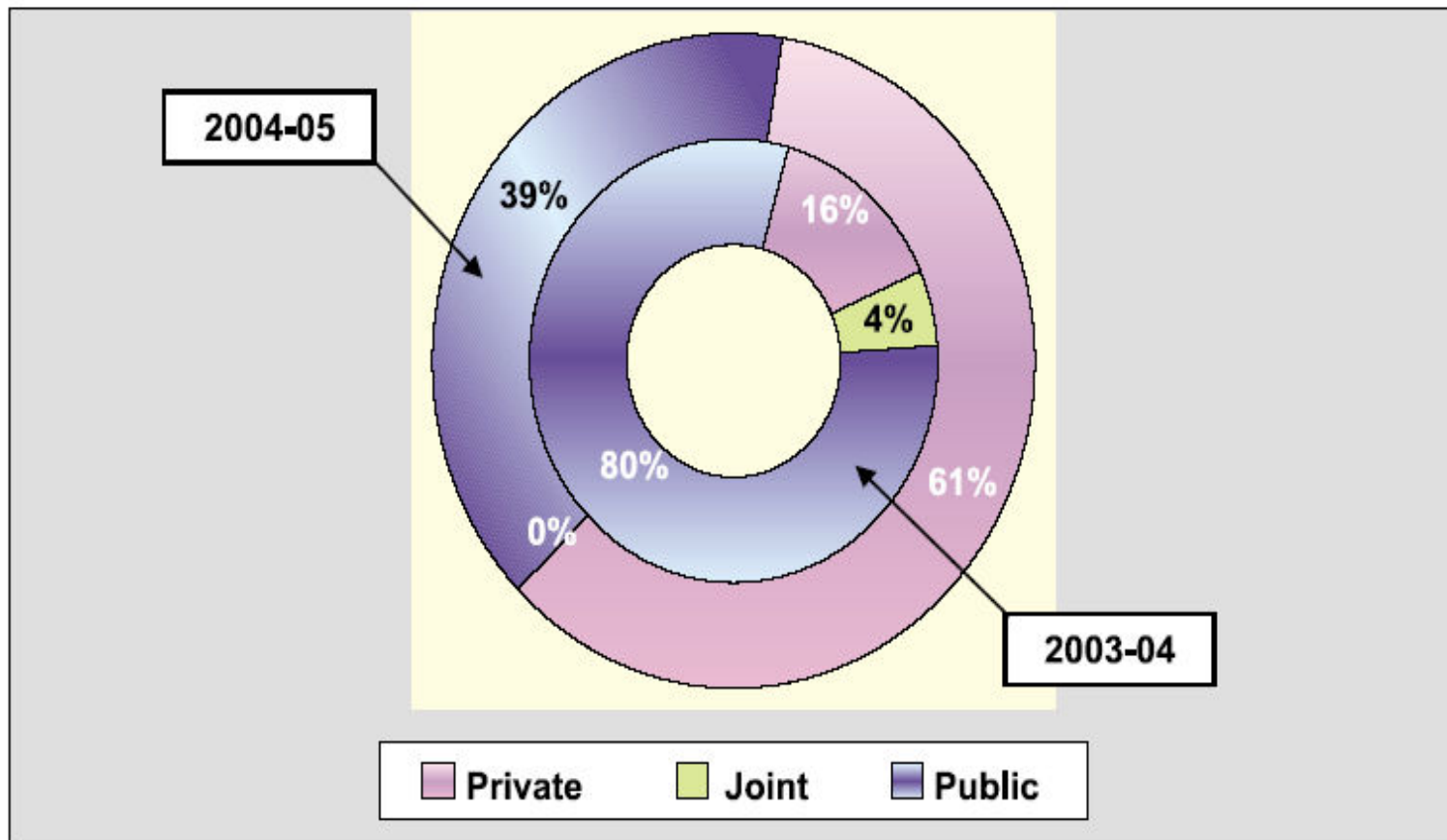
- An independent director is a non-executive director who:
 - (i) aside from director's remuneration, does not have any material pecuniary relationship or transactions with the company, its promoters, management or subsidiaries which may affect the independence of judgment,
 - (ii) is not related to the promoter or a person in management on the board or one level below the board,
 - (iii) has not been an executive for the past three years,
 - (iv) is not or has not been a partner in the past three years of a statutory or internal audit firm or a firm providing consulting services to the company,
 - (v) is not a material supplier, service provider or customer or a lessor or lessee of the company which may affect independence of the director,
 - (vi) is not a substantial (owning 2% or more of voting rights) shareholder of the company. (*SEBI Code, Clause 49*)

- All pecuniary relationship/transactions of non-executive directors should be disclosed in the annual report. (*SEBI Code, Clause 49*)
- No specific provision mandating the creation of a board-level nominating committee. The directors of the Board are appointed by the company in the Annual General Meeting. At the time of appointment of a new director or the re-appointment of a director, shareholders must be provided with a brief résumé of the director, nature of his expertise in specific functional areas and names of companies in which the person also holds other directorships.

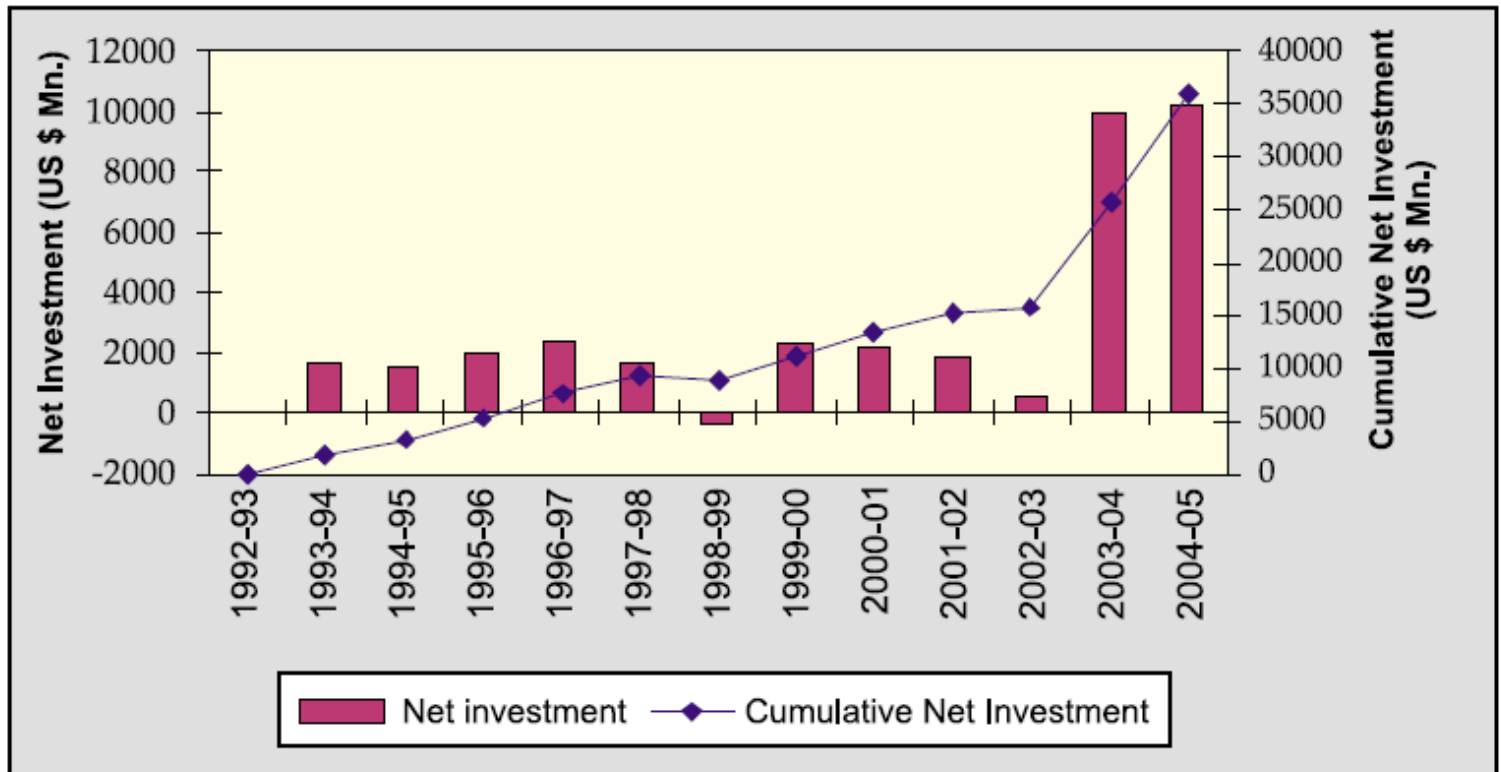
Fundamental Characteristics of India's SOX Laws: Penalties

- The latest reforms as prescribed by Clause 49 have **weak enforceable penalties for noncompliance**. The severest penalty for non-compliance with Clause 49 is the de-listing of a security. However, under current practices companies are seldom de-listed.
- Regulatory authorities view **de-listing as hurting minority investors by taking away their ability to exit equity markets**. As a result there are over 1,000 non-compliant companies (approximately 20 percent of total companies) listed on the Bombay Stock Exchange.
- Although these companies account for less than 5 percent of total market capitalization and have little or no trading volume, the reluctance of regulators to take action against errant companies raises **concerns regarding the enforcement and surveillance mechanisms in the country**.

Effects of Clause 49: Rush Back to Privatization?



Trends in Foreign Institutional Investors in India





Conclusion
