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LESSON OUTLINE

- Introduction of CG & an overview
- Definition
- The OECD of CG
- Benefit of CG
- Need for CG
- Principles of CG
- SEBI code of CG
- CG -History in India
- CG in India-past, present &future
- Perspective & important issues in CG
- CG theory &practice
- Theory of corporate internal control
- CG in practice &Competition
- Governance linked with competition
- Good governance meaning &concept
- Origin &emergence of the concept of good governance
- Features and element of good governance
- Significance of good governance

- Agency theory of CG
- Introduction of agency theory
- Role of agency theory in CG
- Steward ship theory of CG
- Share holder & Stakeholder theory of CG
- Stake holders & their effect on business

LEARNING OBJECTIVES

After Reading this lesson you should be able to

- Introduction &Definition of CG
- What is OECD Of CG
- Need and Importance of CG
- What are the principles of CG
- Define SEBI code
- History in India of CG
- What are the perspective& importance issues in CG
- Theory of corporate internal control
- Discuss the meaning and importance of good governance
- Meaning and definition of Agency theory
- What is the theory of share holder and stakeholder of CG

INTRODUCTION

Corporate Governance refers to the way a corporation is governed. It is the technique by which companies are directed and managed. It means carrying the business as per the stakeholders' desires. It is actually conducted by the board of Directors and the concerned committees for the company's stakeholder's benefit. It is all about balancing individual and societal goals, as well as, economic and social goals.

Corporate Governance is the interaction between various participants (shareholders, board of directors, and company's management) in shaping corporation's performance and the way it is proceeding towards. The relationship between the owners and the managers in an organization must be healthy and there should be no conflict between the two. The owners must see that individual's actual performance is according to the standard performance. These dimensions of corporate governance should not be overlooked.

Corporate Governance deals with the manner the providers of finance guarantee themselves of getting a fair return on their investment. Corporate Governance clearly distinguishes between the owners and the managers. The managers are the deciding authority. In modern corporations, the functions/ tasks of owners and managers should be clearly defined, rather, harmonizing.

Corporate Governance deals with determining ways to take effective strategic decisions. It gives ultimate authority and complete responsibility to the Board of Directors. In today's market- oriented economy, the need for corporate governance arises. Also, efficiency as well as globalization are significant factors urging corporate governance. Corporate Governance is essential to develop added value to the stakeholders.

Corporate Governance ensures transparency which ensures strong and balanced economic development. This also ensures that the interests of all shareholders (majority as well as minority shareholders) are safeguarded. It ensures that all shareholders fully exercise their rights and that the organization fully recognizes their rights.

Corporate Governance has a broad scope. It includes both social and institutional aspects. Corporate Governance encourages a trustworthy, moral, as well as ethical environment

1.1 DEFINITION OF CORPORATE GOVERNANCE

The definition of corporate governance most widely used is "the system by which companies are directed and controlled" (Cadbury Committee, 1992). More specifically it is the framework by which the various stakeholder interests are balanced, or, as the IFC states, "the relationships among the management, Board of Directors, controlling shareholders, minority shareholders and other stakeholders". Cadbury Committee[1] (U.K.), 1992 has defined corporate governance as such

1. "Corporate governance is the system by which companies are directed and controlled. It encompasses the entire mechanics of the functioning of a company and attempts to put in place a system of checks and balances between the shareholders, directors, employees, auditor and the management."
2. "Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the board, managers, shareholders and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides this; it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance."
3. Definition of corporate governance by the Institute of Company Secretaries of India is 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".

1.2 THE OECD PRINCIPLES OF CORPORATE GOVERNANCE STATES

"Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined."

While the conventional definition of corporate governance and acknowledges the existence and importance of 'other stakeholders' they still focus on the traditional debate on the relationship between disconnected owners (shareholders) and often self-serving managers. Indeed it has been said, rather ponderously, that corporate governance consists of two elements:

1. **The long term relationship** which has to deal with checks and balances, incentives for manager and communications between management and investors;
2. **The transactional relationship** which involves dealing with disclosure and authority.

This implies an adversarial relationship between management and investors, and an attitude of mutual suspicion. This was the basis for much of the rationale of the Cadbury Report, and is one of the reasons why it prescribed in some detail the way in which the board should conduct itself: consistency and transparency towards shareholders are its watchwords.

As fundamentally important as these traits are, we prefer to take a rather broader view, which places the Cadbury Code and other codes developed since (Combined Code, Sarbanes-Oxley, King, etc) in a wider context and shows its recommendations emerging naturally in the course of a company's evolution. In an early book on corporate governance, also published in 1992, one of the creators of this website developed a definition of corporate governance as consisting of five elements which the board must consider:

- long term strategic goals
- employees: past, present and future
- environment/community
- customers/suppliers
- compliance (legal/regulatory)

1.3 BENEFITS OF CORPORATE GOVERNANCE

- Good corporate governance ensures corporate success and economic growth.
- Strong corporate governance maintains investors' confidence, as a result of which, company can raise capital efficiently and effectively.
- It lowers the capital cost.
- There is a positive impact on the share price.
- It provides proper inducement to the owners as well as managers to achieve objectives that are in interests of the shareholders and the organization.
- Good corporate governance also minimizes wastages, corruption, risks and mismanagement.
- It helps in brand formation and development.
- It ensures organization in managed in a manner that fits the best interests of all.

1.4 NEED FOR CORPORATE GOVERNANCE

The need for corporate governance is highlighted by the following factors:

(i) ***Wide Spread of Shareholders***

Today a company has a very large number of shareholders spread all over the nation and even the world; and a majority of shareholders being unorganized and having an indifferent attitude towards corporate affairs. The idea of shareholders' democracy remains confined only to the law and the Articles of Association; which requires a practical implementation through a code of conduct of corporate governance.

(ii) ***Changing Ownership Structure***

The pattern of corporate ownership has changed considerably, in the present-day-times; with institutional investors (foreign as well Indian) and mutual funds becoming largest shareholders in large corporate private sector. These investors have become the greatest challenge to corporate managements, forcing the latter to abide by some established code of corporate governance to build up its image in society.

(iii) ***Corporate Scams or Scandals***

public confidence in corporate management. The event of Harshad Mehta scandal, which is perhaps, one biggest scandal, is in the heart and mind of all, connected with corporate shareholding or otherwise being educated and socially conscious.

The need for corporate governance is, then, imperative for reviving investors' confidence in the corporate sector towards the economic development of society..

1.5 PRINCIPLES OF CORPORATE GOVERNANCE

The fundamental or key principles of corporate governance are described below**:**

(i) ***Transparency***

Transparency means the quality of something which enables one to understand the truth easily. In the context of corporate governance, it implies an accurate, adequate and timely disclosure of relevant information about the operating results etc. of the corporate enterprise to the stakeholders.

In fact, transparency is the foundation of corporate governance; which helps to develop a high level of public confidence in the corporate sector. For ensuring transparency in corporate administration, a company should publish relevant information about corporate affairs in leading newspapers, e.g., on a quarterly or half yearly or annual basis.

(ii) ***Accountability***

Accountability is a liability to explain the results of one's decisions taken in the interest of others. In the context of corporate governance, accountability implies the responsibility of the Chairman, the Board of Directors and the chief executive for the use of company's resources (over which they have authority) in the best interest of company and its stakeholders.

(iii) *Independence*

Good corporate governance requires independence on the part of the top management of the corporation i.e. the Board of Directors must be strong non-partisan body; so that it can take all corporate decisions based on business prudence. Without the top management of the company being independent; good corporate governance is only a mere dream.

1.6 SEBI CODE OF CORPORATE GOVERNANCE

To promote good corporate governance, SEBI (Securities and Exchange Board of India) constituted a committee on corporate governance under the chairmanship of Kumar Mangalam Birla. On the basis of the recommendations of this committee, SEBI issued certain guidelines on corporate governance; which are required to be incorporated in the listing agreement between the company and the stock exchange.

An overview of SEBI guidelines on corporate governance is given below, under appropriate heads:

(a) *Board of Directors*

Some points in this regard are as follows:

(i) The Board of Directors of the company shall have an optimum combination of executive and non-executive directors.

(ii) The number of independent directors would depend on whether the chairman is executive or non-executive.

In case of non-executive chairman, at least, one third of the Board should comprise of independent directors; and in case of executive chairman, at least, half of the Board should comprise of independent directors.

The expression 'independent directors' means directors, who apart from receiving director's remuneration, do not have any other material pecuniary relationship with the company.

(b) *Audit Committee*

Some points in this regard are as follows:

(1) The company shall form an independent audit committee whose constitution would be as follows:

(i) It shall have minimum three members, all being non-executive directors, with the majority of them being independent, and at least one director having financial and accounting knowledge.

(ii) The Chairman of the committee will be an independent director.

(iii) The Chairman shall be present at the Annual General Meeting to answer shareholders' queries.

(2) The audit committee shall have powers which should include the following:

(i) To investigate any activity within its terms of reference

(ii) To seek information from any employee

(iii) To obtain outside legal or other professional advice

(iv) To secure attendance of outsiders with relevant expertise, if considered necessary.

(3) The role of audit committee should include the following:

(i) Overseeing of the company's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.

(ii) Recommending the appointment and removal of external auditor.

(iii) Reviewing the adequacy of internal audit function

(iv) Discussing with external auditors, before the audit commences, the nature and scope of audit; as well as to have post-audit discussion to ascertain any area of concern.

(v) Reviewing the company's financial and risk management policies.

(c) *Remuneration of Directors*

The following disclosures on the remuneration of directors shall be made in the section on the corporate governance of the Annual Report:

(i) All elements of remuneration package of all the directors i.e. salary, benefits, bonus, stock options, pension etc.

(ii) Details of fixed component and performance linked incentives, along with performance criteria.

(d) *Board Procedure Some Points in this Regards are*

(i) Board meetings shall be held at least, four times a year, with a maximum gap of 4 months between any two meetings.

(ii) A director shall not be a member of more than 10 committees or act as chairman of more than five committees, across all companies, in which he is a director.

(e) *Management*

A Management Discussion and Analysis Report should form part of the annual report to the shareholders; containing discussion on the following matters (within the limits set by the company's competitive position).

(i) Opportunities and threats

(ii) Segment-wise or product-wise performance

(iii) Risks and concerns

(iv) Discussion on financial performance with respect to operational performance

(v) Material development in human resource/industrial relations front.

(f) *Shareholders*

Some points in this regard are:

(i) In case of appointment of a new director or reappointment of a director, shareholders must be provided with the following information:

1. A brief resume (summary) of the director
2. Nature of his expertise
3. Number of companies in which he holds the directorship and membership of committees of the Board.

(ii) A Board Committee under the chairmanship of non-executive director shall be formed to specifically look into the redressing of shareholders and investors' complaints like transfer of shares, non-receipt of Balance Sheet or declared dividends etc. This committee shall be designated as 'Shareholders / Investors Grievance Committee'.

(g) *Report on Corporate Governance*

There shall be a separate section on corporate governance in the Annual Report of the company, with a detailed report on corporate governance.

(h) *Compliance*

The company shall obtain a certificate from the auditors of the company regarding the compliance of conditions of corporate governance. This certificate shall be annexed with the Directors' Report sent to shareholders and also sent to the stock exchange.

1.7 CORPORATE GOVERNANCE – HISTORY IN INDIA

Introduction

Corporate governance is concerned with set of principles, ethics, values, morals, rules regulations, & procedures etc. Corporate governance establishes a system whereby directors are entrusted with duties and responsibilities in relation to the direction of the company's affairs.

The term "governance" means control i.e. controlling a company, an organization etc or a company & corporate governance is governing or controlling the corporate bodies i.e. ethics, values, principles,

morals. For corporate governance to be good the manager needs to meet its responsibilities towards its owners (shareholders), creditors, employees, customers, government and the society at large. Corporate governance helps in establishing a system where a director is showered with duties and responsibilities of the affairs of the company.

Corporate governance concept emerged in India after the second half of 1996 due to economic liberalization and deregulation of industry and business. With the changing times, there was also need for greater accountability of companies to their shareholders and customers. The report of Cadbury Committee on the financial aspects of corporate Governance in the U.K. has given rise to the debate of Corporate Governance in India.

Need for corporate governance arises due to separation of management from the ownership. For a firm success, it needs to concentrate on both economical and social aspect. It needs to be fair with producers, shareholders, customers etc. It has various responsibilities towards employees, customers, communities and at last towards governance and it needs to serve its responsibilities at the best at all aspects.

The "corporate governance concept" dwells in India from the Arthshastra time instead of CEO at that time there were kings and subjects. Today, corporate and shareholders replace them but the principles still remain same, unchanged i.e. good governance.

20th century witnessed the glossy of Indian Economy due to liberalization, globalization, and privatization. Indian economy for the 1st time here was together with world economy for product, capital and lab our market and which resulted into world of capitalization, corporate culture, business ethics which was found important for the existence of corporation in the world market place.

For effective corporate governance, its policies need to be such that the directors of the company should not abuse their power and instead should understand their duties and responsibilities towards the company and should act in the best interests of the company in the broadest sense.

The concept of 'corporate governance' is not an end; it's just a beginning towards growth of company for long term prosperity.

1.8 CORPORATE GOVERNANCE IN INDIA PAST, PRESENT AND FUTURE

Good corporate governance in the changing business environment has emerged as powerful tool of competitiveness and sustainability. It is very important at this point and it needs corporation for one and all i.e. from CEO of company to the ordinary staff for the maximization of the stakeholders' value and also for maximization of pleasure and minimization of pain for the long term business.

Global competitions in the market need best planning, management, innovative ideas, compliance with laws, good relation between directors, shareholders, employees and customers of companies, value based corporate governance in order to grow, prosper and compete in international markets by strengthen their strength overcoming their weaknesses and running them effectively and efficiently in an efficient and transparent manner by adopting the best practices.

Corporate India must commit itself as reliable, innovative and prompt service provider to their customers and should also become reliable business partners in order to prosper and to have all round growth.

Corporate Governance is nothing more than a set of ideas, innovation, creativity, thinking having certain ethics, values, principles etc which gives direction and shape to its people, employees and owners of companies and help them to flourish in global market.

Indian Corporate Bodies having adopted good corporate governance will reach themselves to a benchmark for rest of the world; it brings laurels as a way of appreciation. Corporate governance lays down ethics, values, and principles, management policies of a corporation which are inculcated and brought into practice. The importance of corporate governance lies in promoting and maintains integrity, transparency and accountability throughout the organization.

Corporate governance has existed since past but it was in different form. During Vedic times kings used to have their ministers and used to have ethics, values, principles and laws to run their state

but today it is in the form corporate governance having same rules, laws, ethics, values, and morals etc which helps in running corporate bodies in the more effective ways so that they in the age of globalization become global giants.

Several Indian Companies like PepsiCo, Infuses, Tata, Wipro, TCS, and Reliance are some of the global giants which have their flag of success flying high in the sky due to good corporate governance.

Today, even law has a great role to play in successful and growing economy. Government and judiciary have enacted several laws and regulations like SEBI, FEMA, Cyber laws, Competition laws etc and have brought several amendments and repeal the laws in order that they don't act as barrier for these corporate bodies and developing India. Judiciary has also helped in great way by solving the corporate disputes in speedy way.

Corporate bodies have their aim, values, motto, ethics and principles etc which guide them to the ladder of success. Big and small organizations have their magazines annual reports which reflect their achievements, failure, their profit and loss, their current position in the market. A few companies have also shown awareness of environment protection, social responsibilities and the cause of upliftment and social development and they have deeply committed themselves to it. The big example of such a company can be of Deepak Fertilizers and Petrochemicals Corporation Limited which also bagged 2nd runner up award for the corporate social responsibility by business world in 2005.

Under the present scenario, stakeholders are given more importance as to shareholders, they even get chance to attend, vote at general meetings, make observations and comments on the performance of the company.

Corporate governance from the futuristic point of view has great role to play. The corporate bodies in their corporate have much futuristic approach. They have vision for their company, on which they work for the future success. They take risk and adopt innovative ideas, have futuristic goals, motto, and future objectives to achieve.

With increase in interdepence and free trade among countries and citizens across the globe, internationally accepted corporate governance standards are of paramount importance for Indian Companies seeking to distinguish themselves in global footprint. The companies should always keep improving, enhancing and upgrading themselves by bringing more reliable integrated product and service quality. They should be more transparent in their conduct.

Corporate governance should also have approach of holistic view, value based governance, should be committed towards corporate social upliftment and social responsibility and environment protection. It also involves creative, generative and positive things that add value to the various stakeholders that are served as customers. Be it finance, taxation, banking or legal framework each and every place requires good corporate governance.

Hence corporate governance is a means and not an end, corporate excellence should be end.

1.9 PERSPECTIVE AND IMPORTANT ISSUES IN CORPORATE GOVERNANCE

There are several important issues in corporate governance and they play a great role, all the issues are inter related, interdependent to deal with each other. Each issues connected with corporate governance have different priorities in each of the corporate bodies.

The issues are listed as below:

1. Value based corporate culture
2. Holistic view
3. Compliance with laws
4. Disclosure, transparency, & accountability
5. Corporate governance and human resource management
6. Innovation
7. Necessity of judicial reforms

8. Globalization helping Indian companies to become global giants based on good corporate governance.
9. Lessons from Corporate failure

1. **Value based corporate culture:** For any organization to run in effective way, it needs to have certain ethics, values. Long run business needs to have based corporate culture. Value based corporate culture is good practice for corporate governance. It is a set of beliefs, ethics, principles which are inviolable. It can be a motto i.e. A short phrase which is unique and helps in running organization, there can be vision i.e. dream to be fulfilled, mission and purpose, objective, goal, target.
2. **Holistic view:** This holistic view is more or less godly, religious attitude which helps in running organization. It is not easier to adopt it, it needs special efforts and once adopted it leads to developing qualities of nobility, tolerance and empathy.
3. **Compliance with laws**: Those companies which really need progress, have high ethical values and need to run long run business they abide and comply with laws of Securities Exchange Board Of India (SEBI), Foreign Exchange Regulation Act, Competition Act 2002, Cyber Laws, Banking Laws etc.
4. **Disclosure, transparency, and accountability:** Disclosure, transparency and accountability are important aspect for good governance. Timely and accurate information should be disclosed on the matters like the financial position, performance etc. Transparency is needed in order that government has faith in corporate bodies and consequently it has reduced corporate tax rates from 30% today as against 97% during the late 1970s. Transparency is needed towards corporate bodies so that due to tremendous competition in the market place the customers having choices don't shift to other corporate bodies.
5. **Corporate Governance and Human Resource Management:** For any corporate body, the employees and staff are just like family. For a company to be perfect the role of Human Resource Management becomes very vital, they both are directly linked. Every individual should be treated with individual respect, his achievements should be recognized. Each individual staff and employee should be given best opportunities to prove their worth and these can be done by Human Resource Department. Thus in Corporate Governance, Human Resource has a great role.
6. **Innovation:** Every Corporate body needs to take risk of innovation i.e. innovation in products, in services and it plays a pivotal role in corporate governance.
7. **Necessity of Judicial Reform**[5]: There is necessity of judicial reform for a good economy and also in today's changing time of globalization and liberalization. Our judicial system though having performed salutary role all these years, certainly are becoming obsolete and outdated over the years. The delay in judiciary is due to several interests involved in it. But then with changing scenario and fast growing competition, the judiciary needs to bring reforms accordingly. It needs to speedily resolve disputes in cost effective manner.
8. **Globalization helping Indian Companies to become global giants based on good governance:** In today's age of competition and due to globalization our several Indian Corporate bodies are becoming global giants which are possible only due to good corporate governance.
9. **Lessons from Corporate Failure**[6]: Every story has a moral to learn from, every failure has success to learn from, in the same way, corporate body have certain policies which if goes as a failure they need to learn from it. Failure can be both internal as well as external whatever it may be, in good governance, corporate bodies need to learn from their failures and need to move to the path of success

1.10 CORPORATE GOVERNANCE-THEORY AND PRACTICE

Various theories and philosophies have provided the foundation for the development of alternative forms of corporate governance systems around the world. Furthermore, as economies have evolved through time it appears that corporate executives have deviated from the sole objective of maximizing shareholders' wealth. Owners of the capital have responded to these forces for the purpose of preserving their wealth and earning a reasonable return on their invested capital. Whereas internal corporate control,

external financial market forces, and institutional investors' responses have been effective in securing shareholders' wealth, legal protection needs to be provided for them.

1.10.1 Introduction

As a legal entity, a corporation enters into contracts to produce goods and services and it has the right to own property. Furthermore, the firm can borrow from various lenders and raise cash by issuing shares of its ownership. Shareholders would not only benefit from the earnings generated by the corporation, but by electing members of the board of directors they could indirectly oversee actions undertaken by the managers. These managers, as agents of the shareholders, are expected to perform for the best interest of the owners of the corporation. Corporate managers can add value to common stockholders without decreasing the welfare of the other corporate stakeholders. For example, borrowing a portion of the capital that is needed for financing activities of the firm, would lead to a higher return to common stockholders. This is because borrowing is generally inexpensive for the firm in the face of taxation benefits available to business enterprises. Executive decisions may result in a transfer of wealth from one group of shareholders to the other. For example, by undertaking risky investment projects, greater rewards may be available to common stockholders without any such benefits to bondholders, except for suffering from excessive risk. Corporate managers can also destroy wealth. History tells us numerous examples in which actions undertaken by corporate executives have resulted in bankruptcy of the firm. The managers of a business enterprise, however, could add value for all corporate stakeholders including owners of the capital, labor, and the society at large. This would be a case of Pareto optimality in which the welfare of some group is increased without any decrease in benefits to the others.

1.10.2 The Theory of Corporate Internal Control

Corporate governance is concerned with managing the relationship among various corporate stakeholders. Roe (1994), states that the American corporate governance system emerged as a result of both economic evolution and its democratic philosophy. In effect, the government by deliberately weakening commercial banks gave corporate managers excessive power. U.S. Banks were prevented from becoming corporate shareholders, let alone a large shareholder. U.S. laws further restrained activities of large shareholders. In this manner, the profile of the American corporate shareholding became as widely dispersed as possible. The idea, as expressed by the Coase Theorem, was that in this manner management would need to get the agreement of numerous dispersed shareholders, and thereby act in the best interests of them all. The political view on corporate governance was based on the belief that banks, as lenders to the corporation, should not be able to affect the payoffs to common stockholders. The modern view on corporate governance, as expressed by North (1994), depicts formal and informal contractual agreements among corporate stakeholders. These may include the payoff structure for suppliers of capital such as stockholders and lenders, the incentive structure for corporate managers, and the organizational structure for maintaining an effective balance in bargaining power of employees of the corporation. This humanly designed organizational structure would involve transaction costs for maintaining and enforcing agreements. The neoclassical view assumes that institutions do not matter. Modigliani and Miller (1958), for example, hypothesize that assuming that the investment policy of the firm is known to the market, its total market value would The Journal of American Academy of Business, Cambridge * September 2004 46 be independent of the mix of debt and equity that is used in financing the firm's assets. In particular, the firm's structure of capital claims would not affect its overall cost of capital. As a consequence, investment and financing decisions of the firm would remain independent of each other. In this manner, corporate governance structure of the firm would not contribute to creation of value for shareholders. In contrast to the neoclassical view, Williamson (1988) states that the debt and equity are not mainly alternative financing instruments, but rather an alternative governance structure. Furthermore, whether a project should be financed by debt or equity depends principally on the characteristics of the assets. Re-deployable assets could be financed by debt, while projects that are not re-deployable should be financed by equity. Furthermore, Jensen and Meckling (1976), and Meyers (1977), state that capital structure affect the nature of income to be distributed between the suppliers of the capital. Since bondholders and stockholders are jointly sharing the risk of the firm, maximizing shareholder wealth may not be in line with maximizing the total value of the firm. In addition, the incentive structure of the corporate decision makers can play a significant role on the mix of debt and equity used in financing the firm's assets, and on its capital investments. History shows that managers can create and add value to the firm by proper investment and financing decisions, or they may transfer and redistribute corporate wealth among the stakeholders, as well as destroying shareholders' wealth. In

effect, investment, financing, and the distribution of business profits are all integrated with each other rather than being independent.

1.10.3 Corporate Governance in Practice

Common stockholders have the right to elect their representatives on the board of directors of a corporation. Members of the board of directors assume the responsibility of monitoring, directing and appointing the firm's managers. In this manner disperse shareholders are potentially empowered in setting direction, monitoring performance, and controlling distribution of profits of the corporation. In particular, this internal control mechanism is purported to integrate the interests of common stockholders and the executive managers of a corporation by rewarding good corporate performance. The board of directors has the right and responsibility to remove poorly performing managers. Historically, dissatisfied shareholders have "walked away" from the corporation by selling their shares at depressed prices and thereby incurring losses. Alternatively, major shareholders either through hostile actions, "investor activism," or a friendly approach, "relationship investing," have pursued their objectives of monitoring corporate managers. Furthermore to the extent U.S. corporate laws permit, competing managers would remove incompetent ones and take over poorly performing firms. These aforementioned actions collectively are purported to add value for the existing shareholders. The business judgment rule followed by the U.S. courts, has kept the courts out of corporate decisions. The U.S. Business Law rests on the belief that actions of corporate managers are evaluated and approved by members of the board of directors of the corporation. In particular, corporate actions that have direct effects on shareholders' wealth are assumed to be communicated to them in a timely manner. Therefore, the U.S. courts would not interfere in corporate matters except for fraudulent activities. If members of the board of directors are not able or motivated to control managers, relationship investing is purported to achieve that. Relationship investing is an example of involved ownership of a business enterprise. Large investors tend to act as mentors to the managers of the firm and behave in a supportive and friendly manner. Investors pursue different approaches for maintaining corporate internal control for the purpose of creating a well functioning business enterprise. The underlying reason for the corporate governance system is the stakeholders' pursuit for preserving their respective share of profit earned by business enterprises.

1.10.4 Competition

As per Oxford dictionary, the meaning of Competition is the activity or condition of striving to gain or win something by defeating or establishing superiority over others. Competition in the market means sellers striving independently for buyers patronage to maximize profit or other business objectives. A buyer prefers to buy a product at a price that maximizes his benefits whereas the seller prefers to sell the product at a price that maximizes his profit. Competition makes enterprise more efficient and offers wider choice to consumers at lower prices. This ensures optimum utilization of available resources. It also enhances consumer welfare since consumers can buy more of better quality products at lower prices. Fair Competition is beneficial for the consumers, producers/sellers and finally for the whole society since it induces economic growth. The objective of Competition is free and fair market. It will lead to enhancement of economic freedom and lower barriers to entry for new firms and competitors.

Competition is a dynamic concept with no unique definition, except what is understood in common parlance in the context of Market and Trade. In the manner of speaking, Competition can be likened to what is antithetical to monopoly. While monopoly is pernicious to consumer interest and free and fair trade, Competition affords wide ranging benefits to the consumers. Adam Smith (1776) captured this altruism in his famous book "Wealth of Nations", when he observed:

> "By a perpetual monopoly, all the other subjects of the State are taxed very absurdly in two different ways, first by the high price of goods, which, in case of free trade, could be bought at much cheaper rates and secondly, by their total exclusion from a branch of business, which it might be both convenient and profitable for many of them to carry on."

1.10.5 Governance Linked with Competition

Corporate Governance The word 'Corporate' is associated by legal enactment for the transaction of a business. Similarly, the word 'Governance' means exercise of Authority, Direction or Control. Thus, the concept of 'Corporate Governance' is the system by which the management of a business entity directs and controls the activities in the best interest of the stakeholder. Corporate Governance refers to the way a corporation is governed. It is the technique by which companies are directed and managed. It is all

about balancing individual and societal goals, as well as, economic and social goals. It includes both social and institutional aspects. Corporate Governance encourages a trustworthy, moral, as well as ethical environment. Corporate Governance has competing definitions, but in Margaret Blair's estimation encompasses the "the whole set of legal, cultural and institutional arrangements that determine what publicly traded corporations can do, who controls them, how that control is exercised, and how the risks and returns from the activities they undertake are allocated".5

As per N.R Narayana Murthy, Chairman, Committee on Corporate Governance, SEBI, Mumbai, February 8, 2003

> "Corporate Governance is the acceptance by management of the inalienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It is about commitment to values, about ethical business conduct and about making a distinction between personal and Corporate funds in the management of a Company."

OECD originally defined Corporate Governance as the system by which business corporations are directed and controlled. The Corporate Governance structure specifies the distribution of rights and responsibilities among different participants in the Corporation, such as the Board, Managers, Shareholders and other Stakeholders and spells out the rules and procedures for making decisions on Corporate Affairs. By doing this, it also provides the structure through which the Company objectives are set, and the means of attaining those objectives and monitoring performance.

The OECD also offers a broader definition as Corporate Governance refers to the Private and Public institutions, including laws, regulations and accepted business practices, which together govern the relationship in a market economy between Corporate managers and entrepreneurs (Corporate insiders) on one hand, and those who invest resources in corporations, on the other hand

1.11 GOOD GOVERNANCE: MEANING AND CONCEPT

Defining Good Governance

Good is a term used with great flexibility; Depending on the context, good governance has been said at various times to encompass: full respect of effective participation, human rights, the rule of law, multi-actor partnerships, and accountable processes, political pluralism, transparent and institutions, an efficient and effective public sector, legitimacy, access to knowledge, information and education, political empowerment of people, equity, sustainability, and attitudes and values that foster responsibility, solidarity and tolerance

1.11.1 Origin and Emergence of the Concept of Good Governance

- "Good governance" was initially expressed in a 1989 World Bank publication.
- In 1992, the Bank published a report entitled, Governance and Development, which explored the concept further and its application.
- In 1997, the Bank redefined the concept "good governance" as a necessary precondition for development.

Good governance is to promote and sustain holistic and integrated human development. The central focus is to see how the government enables, simplifies and authorises its people, regardless of differences of caste, creed, class, and political ideology and social origin to think, and take certain decisions which will be in their best interest, and which will enable them to lead a clean, decent, happy, and autonomous existence.

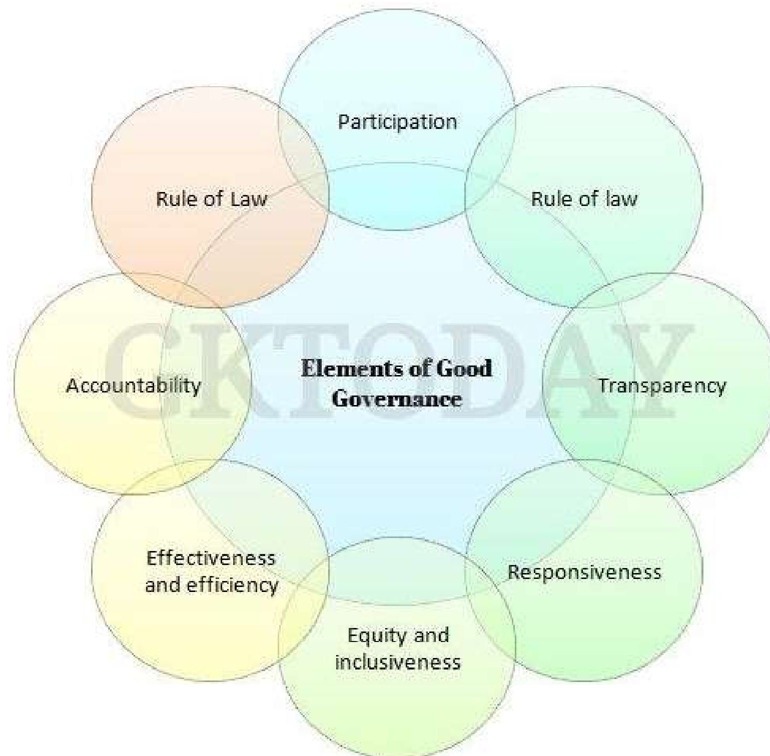
"Good" about governance

Good Governance manages and allocates resources to respond to combined problems of its citizens. Hence states should be assessed on both the quality and the quantity of public goods provided to citizens. The policies that supply public goods are guided by principles such as human rights, democratization and democracy, transparency, participation and decentralized power sharing, sound public administration, accountability, rule of law, effectiveness, equity, and strategic vision.

The Human Development Report issued insists on "good" governance as a democratic exigency, in order to rid corruption, provides rights, the means, and the capacity to participate in the decisions that affect their lives and to hold their governments accountable for what they do.

1.11.2 Basic Features or Elements of Good Governance

Good governance has 8 major characteristics. It is participatory, consensus oriented, accountable, transparent, responsive, effective and efficient, equitable and inclusive and follows the rule of law. It assures that corruption is minimized, the views of minorities are taken into account and that the voices of the most vulnerable in society are heard in decision-making. It is also responsive to the present and fixture needs of society.



Participation

Good governance requires that civil society has the opportunity to participate by both men and women during the formulation of development strategies. This aspect of governance is an essential element in securing commitment and support for projects and enhancing the quality of their implementation. Participation needs to be informed and organized. This means freedom of association and expression and an organized civil society should go hand in hand.

Rule of law

Good governance requires a fair, predictable and stable legal framework enforced impartially. Full protection of human rights, especially minorities should be covered. Impartial law enforcement requires a judiciary to be independent and police force should be impartial and incorruptible.

Transparency

Transparency in government is an important precondition for good governance, and those decisions taken and their enforcement are done in a manner that follows rules and regulations. Transparency ensures that enough information is provided and that it is provided in easily understandable forms and media.

Responsiveness

Good governance requires the institutions to serve all stakeholders in a given time-frame. There are several actors and viewpoints and the different interests in society needs mediation. The best interest of the community should be analysed and achieved which requires a broad and long-term perspective on what is needed and how to achieve the goals of sustainable development.

Equity and inclusiveness

A society's wellbeing depends on ensuring that all men and women have opportunities to improve or maintain their well-being. This requires all groups, especially the most vulnerable, should have opportunities to improve or maintain their standards of life.

Effectiveness and efficiency

Good governance means Processes and institutions produce results that meet needs while making the best use of resources. The concept of efficiency covers the sustainable use of natural resources and the protection of the environment.

Accountability

It is a key requirement of good governance. Both Public and private sector and civil society organizations must be accountable to the public and to their institutional stakeholders. An organization or an institution is accountable to those who will be affected by its decisions or actions. Accountability can be enforced only with transparency and the rule of law.

Rule of Law

Rule of law supports the demand for equity and fairness and means to be impartial, not corrupt and to protect the human rights of all. These are the leading criteria becoming benchmarks one has to keep in mind when striving for good Governance in the decision-making processes.

1.11.3 Significance of Good Governance

India follows republic, democratic and secular form of governance, and the values that are enshrined in our constitution. The term "governance" means a political unit for the functioning of policy-making for both the political and administrative units of Government. Good governance is based on the conviction that man has the ethical and rational ability, as well as the absolute right, to govern himself with motive and just. The concept of good governance is associated with capable and real administration in democratic set up.

In practical terms, there are three particular features of good governance that makes it significance in the working of the government.

- First, the empowerment and capacity of government to frame and implement policies and discharge functions.
- Second, the form of political will.
- Third, the process by which authority is exercised in the management of country's economic and social resources for development.

It also reflects the attitudes of the people towards the functioning of the so many agencies of the government. "Good" governance promotes gender equality, sustains the environment, enables citizens to exercise personal freedoms, and provides tools to reduce poverty, deprivation, fear, and violence. The UN views good governance as participatory, transparent and accountable. It encompasses state institutions and their operations and includes private sector and civil society organizations.

Good governance is significant in public institutions to conduct and manage public affairs and resources to guarantee human rights in free of abuse and corruption, and with due regard for the rule of law.

It is significant because it promises to deliver on the promise of human rights: civil, cultural, economic, political and social rights. Good governance is thus, a function of installation of positive virtues of administration and elimination of vices of dysfunctional ties.

It makes the government work effective, credible and legitimate in administrative system and citizen-friendly, value caring and people-sharing.

1.12 AGENCY THEORY IN CORPORATE GOVERNANCE

What is an agency?

An agent is a person who works for, or on behalf of, another. Thus, an employee is an agent of a company. But agency extends beyond employee relationships. Independent contractors are also agents.

Advertising firms, lawyers, and accountants are agents of their clients. The CEO of a company is an agent of the board of directors of the company. A grocery store is an agent of the manufacturer of corn chips sold in the store. Thus, the agency relationship extends beyond the employee into many different economic relationships. The entity—person or corporation—on whose behalf an agent works is called a principal.

Agency theory is the study of incentives provided to agents. Incentives are an issue because agents need not have the same interests and goals as the principal. Employees spend billions of hours every year browsing the Web, e-mailing friends, and playing computer games while they are supposedly working. Attorneys hired to defend a corporation in a lawsuit have an incentive not to settle, to keep the billing flowing. (Such behavior would violate the attorneys' ethics requirements.) Automobile repair shops have been known to use substandard or used replacement parts and bill for new, high-quality parts. These are all examples of a conflict in the incentives of the agent and the goals of the principal.

Agency theory focuses on the cost of providing incentives. When you rent a car, an agency relationship is created. Even though a car rental company is called an agency, it is most useful to look at the renter as the agent because it is the renter's behavior that is an issue. The company would like the agent to treat the car as if it were her own car. The renter, in contrast, knows it isn't her own car and often drives accordingly

Introduction of Agency Theories

Agency theories arise from the distinction between the owners (shareholders) of a company or an organization designated as "the principals" and the executives hired to manage the organization called "the agent." Agency theory argues that the goal of the agent is different from that of the principals, and they are conflicting (Johnson, Daily, & Ellstrand, 1996). The assumption is that the principals suffer an agency loss, which is a lesser return on investment because they do not directly manage the company. Part of the return that they could have had if they were managing the company directly goes to the agent. Consequently, agency theories suggest financial rewards that can help incentivize executives to maximize the profit of owners (Eisenhardt, 1989). Further, a board developed from the perspective of the agency theory tends to exercise strict control, supervision, and monitoring of the performance of the agent in order to protect the interests of the principals (Hillman & Dalziel, 2003). In other words, the board is actively involved in most of the managerial decision making processes, and is accountable to the shareholders. A nonprofit board that operates through the lens of agency theories will show a hands-on management approach on behalf of the stakeholders.

Agency theory relative to corporate governance assumes a two-tier form of firm control: managers and owners. Agency theory holds that there will be some friction and mistrust between these two groups. The basic structure of the corporation, therefore, is the web of contractual relations among different interest groups with a stake in the company.

Features

In general, there are three sets of interest groups within the firm. Managers, stockholders and creditors (such as banks). Stockholders often have conflicts with both banks and managers, since their general priorities are different. Managers seek quick profits that increase their own wealth, power and reputation, while shareholders are more interested in slow and steady growth over time.

Function

The purpose of agency theory is to identify points of conflict among corporate interest groups. Banks want to reduce risk while shareholders want to reasonably maximize profits. Managers are even more risky with profit maximization, since their own careers are based on the ability to turn profits to then show the board. The fact that modern corporations are based on these relations creates costs in that each group is trying to control the others.

Costs

One of the major insights of agency theory is the concept of costs of maintaining the division of labor among credit holders, shareholders and managers. Managers have the advantage of information, since they know the firm close up. They can use this to enhance their own reputations at the expense of shareholders. Limiting the control of managers itself contains costs (such as reduced profits), while profit seeking in risky ventures might alienate banks and other financial institutions. Monitoring and limiting managers itself contains sometimes substantial costs to the firm.

Significance

The agency model of corporate governance holds that firms are basically units of conflict rather than unitary, profit-seeking machines. This conflict is not aberrant but built directly into the structure of modern corporations.

Effects

It is possible, if one accepts the premises of agency theory, that corporations are actually groups of connected fiefs. Each fief has its own specific interest and culture and views the purpose of the firm differently. In analyzing the function of a corporation, one can assume that managers will behave in a way to maximize their own profit and reputation, even at the expense of shareholders. One might even understand the manager's role as one of institutionalized deceit, where the asymmetry of knowledge permits managers to operate with almost total independence.

1.12.1 The Role of Agency Theory in Corporate Governance?

Agency theory is used to understand the relationships between agents and principals. The agent represents the principal in a particular business transaction and is expected to represent the best interests of the principal without regard for self-interest. The different interests of principals and agents may become a source of conflict, as some agents may not perfectly act in the principal's best interests. The resulting miscommunication and disagreement may result in various problems within companies. Incompatible desires may drive a wedge between each stakeholder and cause inefficiencies and financial losses. This leads to the principal-agent problem.

The principal-agent problem occurs when the interests of a principal and agent are in conflict. Companies should seek to minimize these situations through solid corporate policy. These conflicts present normally ethical individuals with opportunities for moral hazard. Incentives may be used to redirect the behavior of the agent to realign these interests with the principal's. Corporate governance can be used to change the rules under which the agent operates and restore the principal's interests. The principal, by employing the agent to represent the principal's interests, must overcome a lack of information about the agent's performance of the task. Agents must have incentives encouraging them to act in unison with the principal's interests. Agency theory may be used to design these incentives appropriately by considering what interests motivate the agent to act. Incentives encouraging the wrong behavior must be removed and rules discouraging moral hazard must be in place. Understanding the mechanisms that create problems helps businesses develop better corporate policy.

1.13 STEWARDSHIP THEORY OF CORPORATE GOVERNANCE

Introduction: Stewardship Theories

Stewardship theories argue that the managers or executives of a company are stewards of the owners, and both groups share common goals (Davis, Schoorman, & Donaldson, 1997). Therefore, the board should not be too controlling, as agency theories would suggest. The board should play a supportive role by empowering executives and, in turn, increase the potential for higher performance (Hendry, 2002; Shen, 2003). Stewardship theories argue for relationships between board and executives that involve training, mentoring, and shared decision making (Shen, 2003; Sundaramurthy & Lewis, 2003).

Most theories of corporate governance use personal self interest as a starting point. Stewardship theory, however, rejects self-interest. Agency theory begins from self-interested behavior and rests on dealing with the cost inherent in separating ownership from control. Managers are assumed to work to improve their own position while the board seeks to control managers and hence, close the gap between the two structures.

Motivation

For stewardship theory, managers seek other ends besides financial ones. These include a sense of worth, altruism, a good reputation, a job well done, a feeling of satisfaction and a sense of purpose. The stewardship theory holds that managers inherently seek to do a good job, maximize company profits and

bring good returns to stockholders. They do not necessarily do this for their own financial interest, but because they feel a strong duty to the firm.

Identification

Agency and stewardship theories begin from two very different premises. The basic agency problem revolves around individuals considering themselves only as individuals, without any other meaningful attachments. However, stewardship theory holds that individuals in management positions do not primarily consider themselves as isolated individuals. Instead, they consider themselves part of the firm. Managers, according to stewardship theory, merge their ego and sense of worth with the reputation of the firm.

Policies

If a firm adopts a stewardship mode of governance, certain policies naturally follow. Firms will spell out in detail the roles and expectations of managers. These expectations will be highly goal-oriented and designed to evoke the manager’s sense of ability and worth. Stewardship theory advocates managers who are free to pursue their own goals. It naturally follows from this that managers are naturally “company men” who will put the firm ahead of their own ends. Freedom will be used for the good of the firm.

Consequences

The consequences of stewardship theory revolve around the sense that the individualistic agency theory is overdrawn. Trust, all other things being equal, is justified between managers and board members. In situations where the CEO is not the chairman of the board, the board can rest assured that a long-term CEO will seek primarily to be a good manager, not a rich man. Alternatively, having a CEO who is also chairman is not a problem, since there is no good reason that he will use that position to enrich himself at the expense of the firm. Put differently, stewardship theory holds that managers do want to be richly rewarded for their efforts, but that no manager wants this to be at the expense of the firm.

1.14 SHAREHOLDER & STAKEHOLDER THEORY OF CORPORATE GOVERNANCE

The Cadbury Committee 1992 defined corporate governance as “the system by which companies are directed and controlled.” Numerous theories have been proposed on corporate governance best practice, none more popular than the shareholder and stakeholder theories.

Shareholder Theory

The shareholder theory was originally proposed by Milton Friedman and it states that the sole responsibility of business is to increase profits. It is based on the premise that management are hired as the agent of the shareholders to run the company for their benefit, and therefore they are legally and morally obligated to serve their interests. The only qualification on the rule to make as much money as possible is “conformity to the basic rules of the society, both those embodied in law and those embodied in ethical custom.”

The shareholder theory is now seen as the historic way of doing business with companies realising that there are disadvantages to concentrating solely on the interests of shareholders. A focus on short term strategy and greater risk taking are just two of the inherent dangers involved. The role of shareholder theory can be seen in the demise of corporations such as Enron and Worldcom where continuous pressure on managers to increase returns to shareholders led them to manipulate the company accounts.

Stakeholder Theory

Stakeholder theory, on the other hand, states that a company owes a responsibility to a wider group of stakeholders, other than just shareholders. A stakeholder is defined as any person/group which can affect/be affected by the actions of a business. It includes employees, customers, suppliers, creditors and even the wider community and competitors.

Edward Freeman, the original proposer of the stakeholder theory, recognized it as an important element of Corporate Social Responsibility (CSR), a concept which recognizes the responsibilities of

corporations in the world today, whether they be economic, legal, ethical or even philanthropic. Nowadays, some of the world's largest corporations claim to have CSR at the centre of their corporate strategy. Whilst there are many genuine cases of companies with a "conscience", many others exploit CSR as a good means of PR to improve their image and reputation but ultimately fail to put their words into action.

Recent controversies surrounding the tax affairs of well known companies such as Starbucks, Google and Facebook in the UK have brought stakeholder theory into the spotlight. Whilst the measures adopted by the companies are legal, they are widely seen as unethical as they are utilising loopholes in the British tax system to pay less corporation tax in the UK. The public reaction to Starbucks tax dealings has led them to pledge £10m in taxes in each of the next two years in an attempt to win back customers.

1.14.1 Stakeholders and their Effect on Business

The various stakeholders are shareholder, employees, customers, government ,lenders and others and they all have different interests. With the dynamic world, the influence of the stakeholders on setting goals also changes; day-to-day, it becomes tougher for managers to take decisions as in this competent environment they cannot afford to neglect the interest of single stakeholder .Before coming to any conclusion it is preferable if managers analyses their stakeholders thoroughly, sometimes a minor conflict causes big problems.

Shareholder and their interest

Shareholders are the real owner of the business and their main interest is to maximize their wealth. They want that the share price rise as much as possible and if firm unable to fulfill their expectations they can sell their shares that means managers need to consider their interest.

Employees and their interest

Employees are the assets of the business; no doubt they can also be the firm competent edge. Employees also have their interest like future and carrier development; want some bonus or rewards for their performance etc. If managers do not fulfill their interest for the sake of earning more profit, the firm not only loses its employees but also loses market reputation. The ongoing dispute between British Airways and Cabin Crew is the best example of management-employee dispute. British Airways want to save 62.5 million pounds annually by cost cutting in order to remain competent in the market (Holden, 2010). This year, they have already taken 22 days of strike, costing the company more than 150 million pounds (Guardian, 2010). Freeman argued over dispute that company should create values with its employees (UVA Today, 2010). British Airways¶ management is thinking about increasing profit by cost cutting but they are not bothered about their relationship with employees, costing them more than 150 million pounds lose during strikes, moreover market reputation and share price also get affected by this dispute.

Customer and their interest

Customer is the God, every firm produce products for their customers considering their expectations and interest. The customer's interest and expectations is Quality for Price. In today's world customer is more aware and conscious, a firm can afford billions of dollars of loss but it cannot afford to loseits customers. The best example for this is Toyota, in 2010 when it faced the quality problem; the company took a step ahead and recalled more than 9million cars from all around the world; which ultimately cause company loss of billions of dollars (Conner, 2010). No doubt, with the news of allegation of using poor quality of spare parts, the company lost its share price in the market, button February 5, 2010 when Akio Toyoda, president of Toyoda apologized and announced the recall of the Toyota cars, the companies share price ended 4.5% higher 74.71 on the New York Stock Exchange; Investors relieved that announcement as a concrete step to deal with the quality crisis (Reuters, 2010).This case also reveal that share price also get affected by customer satisfaction; as if customers are not satisfied, they can switch to some other product adversely affect sales and profit which ultimately affect the share price of the company

Creditors and their interest

The primary objective of lenders is to get back the amount with interest on time. Some scholars argue that lenders can secure themselves by contracts. But it doesn't mean that lenders are not at all interested in the market performance of the company. Lending institutes lend money to the firms by considering its

market value and previous performance. That means they are not only interested in their returns on time but also in market value of the firm and long-term relationships.

Community and their interest

Business exist in a social environment, business and community have organic relationship. The stakeholder theory state that the main purpose of the businesses not only to maximize wealth but it should also do some social activities because business directly or indirectly affect the environment and society. Tata Group is committed to improve the quality of life of communities they serve(TATA, 2010)

Government and their interest

Governments principle purpose is to ensure that corporate operate according to the law imposed on it and do business by fair means. Government impose lawn the business in order to protect the rights of their citizens moreover they form apex bodies to keep eye on the businesses, as SEBI (Security and Exchange Board of India), its main purpose is to guard the interests of investors in securities and to standardize the security market (SEBI, 2010).

SUMMARY

This unit summarizes overall minimum corporate governance principles and best practices applicable to all organizations (whether public, private or nonprofit). A corporation is created to address objectives which are much more than creating products and services, it has to serve the larger purpose of satisfying multilevel needs of the society. Healthy corporate governance practices are no longer the need of the law but have become essential for the very survival of the organizations, the current economic crisis has proven that beyond doubts.

The corporations have always faced the tug of war of protecting the interests of the shareholders (the legal owners) or the stakeholders which includes suppliers, creditors, government and communities.

This unit discusses certain current best practices as advocated by corporate governance groups and practiced by some Fortune public companies, with the understanding that best practices tend to evolve over time. We proceed on the assumption that a 'best practice' is one in which the benefits to the organization substantially exceed the cost of implementation. What is a best practice today may not be a best practice in the future.

QUESTIONS

Conceptual Types

1. What is CG?
2. Define OECD?
3. Define theory of internal control in CG
4. What is the Meaning of Good Governance?
5. What is the Meaning of Agency?
6. What is Steward ship?
7. Who is share holder?

Analytical Types

1. What is the meaning& overview of CG? Discuss
2. What are the OECD principles &Benefit of CG in states?
3. Why need for CG? Discuss
4. What is SEBI code of CG? Discuss
5. What is the History of India of CG? Discuss
6. Discuss about CG in India present, past, future.

7. What are the perspective & importance issues in CG? Discuss
8. Discuss about the Corporate internal control?
9. What are the Practice of CG?
10. What is Good Governance? Discuss
11. What is an Agency theory? Discuss its importance & Function?
12. What is Stewardship theory of CG?
13. What is the theory of S hare holder & Stake holders of CG?

UNIT 2 CURRENT SCENARIO, OBLIGATION TO INVESTOR

NOTES

Structure

2.1 Principles
2.2 Obligation to Investors, Customers, Employees, Suppliers, Government and Society
2.3 A Land Mark in Indian Corporate History
2.4 Case Study
2.5 Case Study
2.6 National Committees on Corporate Governance
2.7 Issues in Corporate Governance Practices in India
Summary
Questions

LESSON OUTLINE

- Introduction
- Current scenario of CG
- Principle of CG
- Obligation to investors, customer, employees,
- Government &society, Managerial
- A land mark in India CG
- CASE STUDY-CG at Infosys, Alacrity housing
- National committees on CG
- Issues in corporate CG practice in India

LEARNING OBJECTIVES

After going through this unit, you will be able to:

- Meaning & Definition of CG in Current scenario
- What are the principles of Current Scenario?
- Define obligation to investor, customer & employ
- What are the responsibilities of Government?
- What is national committees on CG

INTRODUCTION

In the present century of emerging corporate sectors in the emerging economies and the rise of market economy has paved the way of corporate governance and thereby we can no longer stand going beyond globalization. The further approach in order to carry on with a pace in the world of modern business progress as with the globalization, the need of a proper model and practice of corporate governance round the corner and in the present scenario the interests of the board of directors, business partners, shareholders, employees, and the alike personnel cannot be ignored in the name of organizational value. Such ignorance may lead to internal conflicts among the business societies which may create a downfall in the present world economic progress and in the individual minds related to the business activities. Turmoil may occur where a negative activity may prevail instead of cooperation in the groups who are going to achieve their earnest goals as their achievements and to create a prosperous globalization and market economy thereon. In order to maintain a lively responsibility among the personnel in a society from the very top level to the lower level with a very my-dear relationship and in order to achieve

NOTES

the prosperity which is the bird's eye at any viewpoint, a better managerial activity is very necessary and which can only be adopted through a proper practice of a corporate governance model.

Definition

> 'Corporate governance is, "the framework of rules, relationships, systems and processes within and by which authority is exercised and controlled in corporations." It encompasses the mechanisms by which companies, and those in control, are held to account.'
>
> – Owen, J.; HIH Royal Commission.
>
> "Corporate governance is a dynamic force that keeps evolving."
>
> – Eric Mayne, Chair, ASX Corporate Governance Council.
>
> "Corporate governance describes the structure of rights and responsibilities among the parties that have a stake in a firm."
>
> – Aguilera, R.V. & Jackson, G.

Corporate governance may be termed as to the system which effects the direction and control of the corporations. The corporate governance brings a harmonious relationship in the structure of a corporation regarding the rights and the responsibilities among the different personnel in a corporation and specifies the rules and procedures that how the managers of the different levels, the board of directors, shareholders, creditors, auditors, regulators, and other stakeholders shall make decisions and help themselves to cooperate in the following corporate affairs. At the certain levels, it seeks the structure in which the power and the responsibilities should be distributed among the different personnel. In the modern times the term governance is used which is describing the concept of action taken in what way and various factors of decision and control can be balanced so that the organisation can implement the meaning of capital in the most forthcoming event which is used as the main motive and the most common goal in the present scenario of business entity in order to make a progress and keep a pace in the modern market economy in the market of globalisation in the twenty-first century. The present managerial activities as concerned with an entity are a very much factor to maintain the harmony in order to maintain the level in the modern business environment and to cope up with the other competitive authorities in the system of the corporate sectors

Corporate governance provides the rules and regulations and appropriate control mechanism through which creates a systematic obligation to maintain the propositions in the entities and supervise the total materialistic issues from one level to another hand to hand within a modern scope of business environment which helps in the initiation and development of the activities, building a social scope, and modelling of the entities according to the modern systems which provide a lot of market development in the developing nations with a sustainable development and a continuous involvement in restructuring the main branches of the economy or social sector reforms.

The traditional market system hence belonged to a traditional family oriented basic structure of the business whereby the total concept of the entity was determined by the owner of the business and thereby the owner of the family; thus the autocratic leadership in so many ways used to fluctuate the mind of the employees of the different levels and a sudden breakage to the socio-cultural pattern in the existing firm due to excessive need of proper managerial activities which needs proper managers and determination of a proper leadership. Thus the modern system evolved which is providing an enthusiasm to build a proper relationship among the human society in order to achieve the ultimate goal with a very positive effect in every stream of leadership and to develop a proper model of corporate governance and to utilise it with a very effective practise.

Corporate governance has also been defined as "a system of law and sound approaches by which corporations are directed and controlled focusing on the internal and external corporate structures with the intention of monitoring the actions of management and directors and thereby mitigating agency risks which may stem from the misdeeds of corporate officers.".The term "corporate governance" denotes the entire process by which corporations are managed and controlled. J. Wolfensohn, president of the World Bank has opined that corporate governance is about promoting corporate fairness, transparency and accountability.

The main motive of corporate governance lies with the motion that to strengthen the economic efficiency through a strong emphasis on the stakeholders' welfare and thereby one of its importance arises out is the nature and extent of corporate accountability. Most of the interest in corporate governance is concerned with that of the mitigation of the conflicts arising out of the interests between the stakeholders

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2.1 PRINCIPLES

The 1990 report regarding the three documents along with the discussions of refers to principles of corporate governance which are the *Cadbury Report, 1992* of UK; *OECD Principles of Corporate Governance 1998* and revised on *2004* of OECD; and *the Sarbanes-Oxley Act, 2002*, of US. The Cadbury and OECD reports gives the general principles regarding which businesses are expected to operate and assure proper governance. The Sarbanes-Oxley Act, informally referred to as Sarbox or Sox, is an attempt by the federal government in the United States to legislate several principles recommended in the Cadbury and OECD reports.

- **Rights and equitable treatment of shareholders:** Hereby the organizations are compelled to respect the rights of the shareholders and help them to exercise their rights and the entities are responsible thereon to help the shareholders in exercising their rights by openly an effectively communication and basic information and by encouraging them to participate in the general meetings.
- **Interests of other shareholders:** Organizations should recognize that they have legal, contractual, social, and market driven obligations to non-shareholder stakeholders, including employees, investors, creditors, suppliers, local communities, customers, and policy makers.
- **Role and responsibilities of the board:** The board needs sufficient relevant skills and understanding to review and challenge management performance. It also needs adequate size and appropriate levels of independence and commitment.
- **Integrity and ethical behaviour:** Integrity should be a fundamental requirement in choosing corporate officers and board members. Organizations should develop a code of conduct for their directors and executives that promotes ethical and responsible decision making.
- **Disclosure and transparency:** Hereby accountability is a major factor which is a major mode to be abided in any form of entity according to the rules and regulations. Organizations should clarify and make publicly known the roles and responsibilities of board and management to provide stakeholders with a level of accountability. They should also implement procedures to independently verify and safeguard the integrity of the company's financial reporting. Disclosure of material matters concerning the organization should be timely and balanced to ensure that all investors have access to clear, factual information

2.2 OBLIGATION TO INVESTORS, CUSTOMERS, EMPLOYEES, SUPPLIERS, GOVERNMENT AND SOCIETY

Obligations Towards Owners or Shareholders

In the case of sole trader ship and partnership concerns, the owners can look after their interest themselves. Where as in the case of the company, the directors have the following responsibilities towards the shareholders:

A. **Reasonable Dividend:** shareholders are a source of funds for the company. They Management and Society expect a high rate of dividend on the money invested by them and also the maximization of the value of their investment in the company.

B. **Protection of assets:** The assets of the company are purchased with shareholders funds. Therefore the company is responsible to safeguard these assets.

C. **Information:** It is the responsibility of the management to keep the shareholders informed about the financial position as well as the progress of the company.

Obligations towards Customers

Customer's satisfaction is the ultimate aim of all economic activity. Therefore, it is, theduty of management

a. To make goods of the right quality available to the right people at the right time andplace and at reasonable prices.

b. The business should not indulge into unfair practices such as black marketing, hoarding, adulteration etc.

c. To provide prompt and courteous service to customers.

d. To handle customers grievances carefully.

e. To distribute the goods and services properly so that the customers do not face any difficulty in purchasing them.

f. To produce goods which meet the needs of the customer who belong to different classes, tastes and with different purchasing power.

Obligations towards Employees

Employees should be treated as human beings and their co-operation must be achieved for the realization of organizational goals. The business should fulfil the following obligations towards their employees.

a. Fair wages: Business should pay reasonable salaries so that their employee's may lead a good life and satisfy their needs.

b. Adequate benefits: Employees should be provided benefits like housing, insurance cover, medical facilities and retirement benefits.

c. Good Working Conditions: Good working conditions are necessary to maintain the health of the workers. Therefore they must be provided with good working conditions.

d. Opportunity for Growth: Business should give their employees opportunity to develop their capabilities through training and education.

e. Recognition of Worker's Rights: The business should recognize the worker's right to fair wages, to form trade unions, to collective bargaining etc.

f. Co-operation: The business must win the co-operation of the workers by creating the conditions in which workers are willing to put forward their best efforts towards the common goals of the business.

Responsibility towards Suppliers

The business must create healthy relations with the supplier. Management should deal with them judiciously. They should be provided with fair terms and conditions regarding price, quality, delivery of goods and payment.

Obligations towards Government

It is the duty of every business enterprise to manage its affairs according to the laws affecting it. It should pay taxes and other dues honestly. It should not encourage corruption,black marketing and other social evils. It should discourage the tendencies of concentration of economic power and monopoly and should encourage fair trade practices.

Obligation towards Society

Every business owes an obligation to the society at large. The following are the important obligations of business towards society.

a. Socio-Economic Objectives: A business should not indulge in any practice which is not fair from social point of view. The business should use the factors of production effectively and efficiently for the satisfaction of the needs of the society.

b. Employment Opportunities: It is the responsibility of management to help increase direct and indirect employment in the area where it is functioning.

c. Efficient use of Resources: The resources at the command of business belong to the society. Therefore, the business should make the best possible use of the resources at its disposal for the well being of the society.

d. Business Morality: The business should not indulge into anti-social and unfairtrade practices such as adulteration, hoarding and black marketing.

e. Improving local environment: Business should take preventive measures against water and air pollution. It can develop the surrounding area for the well being of the employees and the general public. A business can also contribute to the advancement of local amenities.

Managerial Obligations to Society

Society contributes its resources to a company. It becomes duty of the corporate to give back to society. In today's world no company can afford to ignore its social obligations. Otherwise the company will lose its trust and faith in the society.

As the company makes profit, grows financially and progresses the same way the society should also more forward. If there is an oasis of affluence in a desert of neglect, it will call for dangers ahead.

A company is part and parcel of a society hence it cannot isolate or close its eyes. The society is a stakeholder. Indian companies are allocating funds or part of their net profits for social development and taking active part in uplifting the needy and down trodden.

Companies have taken up social work in the areas of:

(i) Primary education,
(ii) Providing education facilities,
(iii) Building large university,
(iv) Giving medical facilities to rural areas,
(v) Creating human capabilities,
(vi) Upliftment of backward areas,
(vii) Women education, literacy,
(viii) Sanitary, health and greening.

The process is bringing positive image of the companies. Social commitment is not against creating profits, it is an addition to profits in long range.

Management Obligation to Investors

A corporate governance structure in a company should provide a frame work to protect the rights of shareholders. That is one vote for one share.

To active this salient features are:

(i) It should ensure that management provides sufficient and relevant information in time.
(ii) It should encourage share holder participation in annual general meetings and vote.
(iii) Shareholders should get sufficient dividends or residual profit to stay with the company.
(iv) Minority shareholders are protected against the oppression of large shareholders.
(v) Ensure transparency and fairness in the operations of the company.
(vi) Keep the reputation or brand image high image of the company to attract and retain investments.
(vii) Addressing the grievances of the shareholders.
(viii) Equitable treatment to all shareholders.
(ix) Provide disclosure information relevant to stakeholders

2.3 A LAND MARK IN INDIAN CORPORATE HISTORY

As corporations increasingly access global pools of financial and human capital, partner with vendors on mega collaborations, and are required to function in harmony with the community, corporate governance becomes imperative.

India is close to having one million registered companies, and the need for a strong company legislation is even greater. The new Companies Act intends to bring governance standards on par with those in developed nations through several key provisions, such as composition and function of Board of directors, code for independent directors, performance evaluation of independent directors, class action suits, auditor rotation and independence, and establishment of Serious Fraud Investigation Office.

Board of directors

The Act recognises the Board as a key component and entrusts it with significant responsibilities for strong internal controls and risk management.

Besides the audit committee, listed and prescribed class of companies should constitute the nomination and remuneration committee and stakeholder relationship committee. The Act stipulates appointing at least one woman director in listed and prescribed class of companies.

Independent directors

The concept of independent directors has been introduced for the first time in the Companies Act.

The Act lays down the qualification, code of professional conduct (includes assisting companies in implementing best corporate governance practices), performance evaluation mechanism, and duties of independent directors. Independent directors will now have greater responsibility to ensure a vigilant and active board.

While this is a welcome step, there may be an element of subjectivity when enforcing compliance.

Class action suits

The concept of class action suits is prevalent in countries like the US and the UK. The Companies Act now allows a requisite number of members or depositors or any class of them to file an application before the National Company Law Tribunal (NCLT), if they feel that the company's affairs are being conducted in a manner prejudicial to the interests of the company, its members or depositors.

The average value of a settlement in the US in the first half of 2012 was $71 million — a sharp rise from $46 million during 2005–2011. Major allegations in the suits included operational shortcomings/ product defects (45 per cent), followed by accounting, breach of fiduciary duty, and customer/ vendor issues.

Audit and auditors

Auditor rotation has been made mandatory for listed and prescribed class of companies. Severe penal provisions have been introduced to enforce compliance. Most countries do not have mandatory rotation of audit firms, even as they mandate the rotation of audit partners. Regulators in the UK, the US, and Germany have discussed the topic in the past, but concluded that the potential benefits of mandatory rotation do not outweigh the risks and costs.

Fraud Investigation

The Government shall establish a Serious Fraud Investigation Office (SFIO) for companies, and stringent penal provisions have been defined for fraud-related offences.

In summary, the Act is a landmark development in the Indian corporate landscape. The impact of the new pronouncement should not be underestimated, and companies and other stakeholders should start evaluating the implications and act swiftly.

The Ministry of Corporate Affairs will have to proactively issue circulars and clarifications to ensure the act is implemented in the right spirit.

2.4 CASE STUDY

Corporate Governance at Infosys

By the late 1990s, Infosys Technologies Limited (Infosys)[1] had clearly emerged one of the best managed companies in India. Its corporate governance practices seemed to be better than those of many other companies in India. Because of its good governance practices, Infosys was the recipient of many awards. In 2001, Infosys was rated India's most respected company by Business World[2]. Infosys was also ranked second in corporate governance among 495 emerging companies in a survey conducted by Credit Lyonnais Securities Asia (CLSA) Emerging Markets. It was voted India's best managed company five years in a row (1996-2000) by the Asia money poll. In 2000, Infosys had been awarded the "National Award for Excellence in Corporate Governance" by the Government of India. In 1999, Infosys had been selected as one of Asia's leading companies in the Far Eastern Economic Review's REVIEW 2000 Survey and voted India's most admired company by The Economic Times. Infosys had also provided all the information required by the Cadbury committee[3] Infosys had benchmarked its corporate governance

practices against those of the best managed companies in the world (Refer Exhibit I for broad structures and processes for good governance).

It was one of the first companies in India to publish a compliance report on corporate governance, based on the recommendations of a committee constituted by the Confederation of Indian Industries (CII).[4] Infosys maintained a high degree of transparency while disclosing information to stakeholders. It had been providing consolidated financial statements under US GAAP to its global investors and financial statements under Indian GAAP to Indian shareholders. Infosys provided details on high and low monthly averages of share prices in all the stock exchanges on which the company's shares were listed. It was one of the few companies in India to provide segmentwise breakup of revenues.

Code of Corporate Governance

In the late 1990s, the Confederation of Indian Industries (CII) published a code of corporate governance (Refer Exhibit II for the highlights of the report). In 1999, the Securities and Exchange Board of India (SEBI) appointed a committee under the Chairmanship of Kumar Mangalam Birla[5] to recommend a code of corporate governance. The report was submitted by the committee in November 1999 and accepted by SEBI in December 1999 (Refer Exhibit III for the highlights of the report).

Infosys had accepted the recommendation of both the CII and the Kumar Mangalam Birla Committee. This section provides an overview of corporate governance practices followed by Infosys.

Infosys had an executive chairman and chief executive officer (CEO) and a managing director, president and chief operating officer (COO). The CEO was responsible for corporate strategy, brand equity, planning, external contacts, acquisitions, and board matters. The COO was responsible for all day-to-day operational issues and achievement of the annual targets in client satisfaction, sales, profits, quality, productivity, employee empowerment and employee retention. The CEO, COO, executive directors and the senior management made periodic presentations to the board on their targets, responsibilities and performance.

In 2001, the board had sixteen directors. There were eight executive directors and eight non-executive directors (Refer Table I). Infosys believed that the one thing that could help them to improve corporate governance was to bring international professionals on corporate boards

The board members were expected to possess the expertise, skills and experience required to manage and guide a high growth, hi-tech software company. Expertise in strategy, technology, finance, and human resources was essential. Generally, they were between 40 and 55 years of age and were not related to the other board members. They did not serve in any executive or non-executive position in any company in direct competition with Infosys. The board members were expected to rigorously prepare for, attend, and participate in all board and relevant committee meetings. Each board member was expected to ensure that other existing and planned future commitments did not interfere with the member's responsibility as a director of Infosys.

Normally, the board meetings were scheduled at least a month in advance. Most of the meetings were held at the company's registered office at Electronics City, Bangalore, India. The chairman of the board and the company secretary drafted the agenda for each board meeting and distributed it in advance to the board members. Board members were free to suggest the inclusion of any item on the agenda. Normally, the board met once a quarter to review the quarterly results and other issues. The board also met on the occasion of the annual shareholders' meeting. If the need arose, additional meetings were held. The non-executive directors had to attend at least four board meetings in a year. The board had access to any information that it wanted about the company.

In 2001, the board had three committees - the nominations committee, the compensation committee and the audit committee. To ensure independence of the board, the members of the nominations committee, the compensation committee and the audit committee were all non-executive directors.

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Corporate Governance - The Infosys Way Contd...

Table I *Composition of the Board (2001)*

Executive Directors	Profile
Narayana NR Murthy	Chairman of the Board and CEO since 1981. Also served as managing director until February 1999.
Nandan M Nilekani	Co-founder of Infosys. Managing Director, COO and President since February 1999.
S Gopalkrishnan	Co-founder of Infosys. Deputy Managing Director, Head of Customer Service & Technology.
K Dinesh	Co-founder of Infosys. Head of HRD, IS, Quality & productivity.
SD Shibutal	Co-founder of Infosys. Head of Customer Delivery.
TV Mohandas Pai	CFO, Head of Administration and Facilities.
Phaneesh Murthy	Head of Sales & Marketing.
Srinath Batni	Head of West North America.
NON-EXECUTIVE DIRECTORS	
Deepak M Satwalekar	Managing Director of Housing Development Finance Corporation Ltd. since 1993.
Dr Marti G Subrahmanyam	Charles E. Merrill Professor of Finance and Economics at the Stern School of Business at New York University since 1993.
Ramesh Vangal	President of Seagram Asia Pacific since 1997.
Philip Yeo	Executive Chairman of the Singapore Economic Development Board. Also, Deputy Chairman of the National Science and Technology Board and Chairman of Pidemco Land, a subsidiary of the Singapore Technologies Group.
Senator Larry Pressler	Member of Congress for 22 years. A senior partner in the Washington, D.C. law firm of O'Conner & Hannan.
Dr Omkar Goswami	Senior Consultant and Chief Economist to the Confederation of Indian Industry (CII).
Dr Jitenrda Singh	Saul P. Steinberg Professor in the Department of Management at the Wharton School, University of Pennsylvania.
Rama Bijapurkar	A recognised thought leader on marketing strategy and consumer related issues in India and runs a strategic marketing consulting practice working across a wide range of sectors, helping organizations develop marketing strategies.

Source: Annual Report, 2000-01

The nominations committee had four non-executive directors who looked after the issue of retirement of existing members and their re-appointment, on the basis of their performance. The nominations committee constantly evaluated the contribution of the members of the board and recommended to shareholders their re-appointment. The executive directors were appointed by the shareholders for a maximum period of five years, but were eligible for re-appointment upon completion of their term. The nominations committee adopted a retirement policy for the members of the board under which the maximum age of retirement of executive directors, including the CEO, was 60 years, which was the age of superannuation for the employees of the company. Their continuation as members of the board upon superannuation / retirement was determined by the nominations committee.

The compensation committee, which had three non-executive directors, looked after issues relating to compensation and benefits for board members. It determined and recommended to the board, the compensation payable to the members of the board. The compensation of the executive directors consisted of a fixed component that was paid monthly, and a variable component, which was paid quarterly, based on performance. The annual compensation of the executive directors was approved by the compensation committee within the parameters set by the shareholders at the shareholders meetings. The shareholders determined the compensation of the executive directors for the entire period of their term.

The compensation of the non-executive directors was approved at a meeting of the full board. The components were a fixed amount, and a variable amount based on their attendance of the board and committee meetings. The total compensation payable to all the non-executive directors together was limited to a fixed sum per year determined by the board.

This sum was within the limit of 0.5% of the net profits of the company for the year calculated, as per the provisions of the Companies Act and as approved by the shareholders. The compensation payable to the non-executive directors (and the method of calculation) was disclosed in the financial statements. Since 1999, the non-executive directors were eligible for stock options. Of the compensation payable for the year 1999, 60% was paid for being on the board and the balance 40% was paid in proportion to the board/committee meetings attended (Refer Table II for compensation payable to non-executive directors in 1999).

Table II *Compensation Payable to Non-Executive Directors (1999)*

Name	Pro rata compensation	Compensation payable on attendance	Total
Susim M. Datta*	0.36	0.3	0.66
Deepak M. Satwalekar	0.36	0.36	0.72
Ramesh Vangal	0.36	0.1	0.46
Dr.Marti G. Subrahmanyam	0.36	0.2	0.56
Total	1.44	0.96	2.4

*Susim M Datta retired from the board in 2000.

In 1999, the board had four non-executive directors and six executive directors.

Source: Annual Report, 1998-99

None of the directors gained financially from any other contract of significance which the company or any of its subsidiary undertakings was party to.

The audit committee was responsible for effective supervision of the financial reporting process, ensuring financial and accounting controls and compliance with the financial policies of the company. The committee periodically interacted with the statutory auditors and the internal auditors to ascertain the quality of the company's transactions; to review the manner in which they were performing their responsibilities; and to discuss auditing, internal control and financial reporting issues. The committee provided overall direction on the risk management policies and also indicated the areas that internal and management audits should focus on. The committee had full access to financial data. The committee reviewed the annual and half yearly financial statements before they were submitted to the board. The committee also monitored proposed changes in the accounting policy, reviewed the internal audit functions and discussed the accounting implications of major transactions.

As per the recommendations of the Kumar Mangalam Committee, Infosys included a separate section on corporate governance in its annual report, which disclosed the remuneration paid to directors in all forms, including salary, benefits, bonuses, stock options. The annual report also carried a compliance certificate from the auditors.

Infosys also laid emphasis on succession planning and management development. The chairman reviewed succession planning and management development with the board from time to time. The chairman and CEO also managed all interaction with the investors, media, and the government. Where necessary, he took advice and help from the managing director, president, and COO as well as the CFO. The managing director and COO managed all interactions with the clients, taking the advice and the help of the CEO. Both the CEO and the COO handled employee communication.

Infosys-A Benchmark for Corporate Governance

Some analysts felt that Infosys' corporate governance practices offered many lessons to corporate India. Infosys had shown that increasing shareholder wealth and safeguarding the interests of other stakeholders was not incompatible. Infosys had given its non-executive directors the mandate to pass judgement on the efficacy of its business plans. Every non-executive director not only played an active role in decision making, but also led or served on at least one of the three (Nomination, Compensation and Audit) committees. Infosys' founders had set very high standards, in a country where malpractices by founders were rampant. The founders only took salaries and dividends and derived no other financial benefits from the company.

Commenting on the strengths and weaknesses of Infosys' corporate governance, Nandan M Nilekani, Managing Director, Chief Operating Officer and President of Infosys, said, "The strengths are

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that we have been very successful in creating a value based system with a very strong focus on ethics, and strong division between personal and professional funds etc. That has translated into brand equity, shareholder value etc.

Obviously, we can do things better. We believe that we can never stand still. We will keep looking at global best practices, what the world is saying on this front. We keep trying to improve the way we manage to be on par with it." It remained to be seen whether other Indian companies could emulate Infosys form of corporate governance

2.5 CASE STUDY

Alacrity Housing

In India, the housing and construction sector accounted for about 40-50% of the capital expenditure on infrastructure projects in a year. The sector contributed significantly to the economy, enhancing GDP, increasing income and generating employment. The construction activity accounted for about 50% of the development outlay in India. Till the late 1980s, the housing and construction sector was not given the status of an industry. The sector required a scientific approach for the management of materials, machines, manpower and money, and general management discipline to become organized and get the status of an industry.

With the formulation of the National Housing Policy (NHP) in 1989-1990,[2]the construction business started to be recognized as an industry. In addition, the government lost its monopoly status in the industry; instead, it now became a facilitator and monitor of the industry. Soon after the NHP was announced, the industry grew alarmed at the unethical practices followed by many people in the industry. Because of this unethical behavior, there was crisis of confidence between the supplier and the consumer

The unprofessional and unethical practices covered a whole range of activities in the industry. These included illegal, unauthorized and unsafe constructions; black money transactions; time and cost overruns; exploitative profit margins etc. Bribery was common in the industry since many corrupt government officials demanded huge amounts for issuing permits and clearances for drainage, water and electricity connections, and no-objection certificates etc.

Time and cost overruns were also very common. The builders never seemed to give possession of the flat/house on time. The price too, was never the same as agreed on initially and increased substantially due to the project cost overrun. Laborers were exploited and not paid even minimum wages. There was also discrimination against women.

In addition, black money transactions were common in the industry. No contractor or builder objected to this practice. The underworld was also involved in the construction industry. Builders sought the help of the underworld to remove encroachments on the plots they were going to develop. In return, the underworld demanded huge sums of money.

To self regulate the industry and weed out corruption, the National Real Estate Development Council (NAREDCO) was established in 1998. To improve the confidence level of investors and consumers in the real estate sector, NAREDCO took measures to improve transparency in real estate transactions. It represented all enterprises dealing with various aspects of real estate development including land development; lay-out; planning; construction of residential; commercial and institutional buildings/ complexes; development of townships; provision of urban infrastructure (roads, electricity, drainage, sewerage, water supply) and social infrastructure (recreational, educational and medical facilities); architecture; town planning; supply of building materials; estate finance insurance; and estate marketing and brokerage; and other allied fields. A Code of Ethics was developed (Refer Exhibit I). NAREDCO also developed a rating system in association with CRISIL[3] to facilitate prudent investment decisions in real estate ventures.

Even though unethical and corrupt behavior was common in the housing and construction industry, one company - Alacrity Housing believed that it paid to run an honest business. The company strongly opposed to the unethical behavior so common in the industry. It did not believe in giving bribes or dealing in black money. Analysts doubted that such a company could survive for long in a corrupt business environment

Alacrity Foundations Private Limited (Alacrity) was founded in 1978 by Amol Karnad (Karnad)[4]. Karnad believed that personal dignity and integrity were vital for an individual's spiritual progress in life, and that work was the medium for the true expression of these qualities.

Karnad's views on the dignity and glory of the human being were influenced by philosopher and novelist Ayn Rand. His views on organisation and management by Peter Drucker[5]. He set up a management consultancy to test his ideas. The consultancy showed mixed results. Though clients seemed happy and did not mind paying a fee to listen to the recommendations, they were not very enthusiastic when it came to implementation. They felt that the consultancy comprised of "smart young people with ideas, but really quite impractical."

However, Karnad was not discouraged by the response. He decided to pursue his convictions by launching his company operations in 1981. With the help of research in management and some propositions (Refer Exhibit II for the propositions), he formulated Alacrity's corporate mission: "To try and prove that organized business when deeply committed to human values is the best equipped to lead society to a better quality of life." Karnad strongly believed that business could play a crucial role in evolving a new ethical social order.

Alacrity planned to establish businesses, which were in line with national goals and generated both employment and purchasing power. Accordingly, Alacrity identified three thrust areas: Housing, Electronics (Energy Management), and Healthcare and Education. Of these, urban housing and energy management were chosen as Alacrity's first streams of business.

When hunting for a flat after marriage, Karnad realized that he could not afford one. It seemed very strange to him that there were no large corporations in a field as basic as shelter. Karnad said, "This gave me an insight into the manner in which the construction industry functioned. Market confidence in the developer was low, mainly because the industry was not organized. Clearly, there was a niche for a construction firm which promised reliability and accountability."

This prompted Karnad to enter the housing business. So when Karnad's uncle, Indukanth Ragade (Indukanth), who went on to become the Vice President of Alacrity, wanted to develop his property in Chennai, Karnad took up the project even though he was not a civil engineer. Consequently, in the early 1980s Alacrity started its housing operations in Chennai. The housing sector was then marked by fly-by-night companies which did not have a favorable market regulation and which associated with bribery, time and cost overruns, and poor quality and service.

Despite the uncertainty and high risks of the construction business, Karnad sensed an opportunity. Initially, the company built housing complexes for its employees and their friends. The houses were priced economically, without any reference to the market rate. The price struck a balance between a reasonable return to the business and a fair price that the people could afford. As a result, the price was about two-thirds the prevailing market price.

Alacrity introduced many new, value-added features. The company offered its customers a one-year warranty and after sales service. During the warranty period, Alacrity offered free maintenance to the house owners. After the warranty period, any services required by the owners were charged reasonably.

To maintain a good relationship with its customers, Alacrity bore any price escalation caused by project cost overruns or increase in the prices of raw materials. The company also tried to get its suppliers to commit to a particular rate.

The customers had to pay only the price that was agreed on when they signed the contract. Alacrity also promised to pay customers the rent they would have to pay for living elsewhere, if there was a time overrun.

By building a reputation for honesty, Alacrity attracted people who wanted to invest their money with a builder they could trust. Alacrity offered a fixed price and also underwrote all cost overruns thereafter. The company also compensated by way of liquidated damages for any delay in the delivery of a project, even if the delay was beyond the control of the company. People seemed to appreciate these considerate policies. In a survey conducted by an independent agency that required resondents to prioritise the builders preferred by them, more than 60% named only Alacrity.

However, because of its ethical policies, company faced many problems. In one particular case, the company's project was held up because it could not secure electricity supply for its housing complex.

Though Alacrity's Government Relations Team actively pursued the matter with the concerned department, it was not successful. Because of this delay, the liquidated damages to be paid to customers added up to several million rupees. Customers became impatient and started questioning Alacrity's policies. But, Alacrity stood by its priniciples.

To pressurize the electricity departments, one of the customers wrote to the Governer, asking him to intervene to help an honest builder. However, the Governer was unable to influence the department. Fortunately, after several days, electric supply was provided and the apartments were handed over to their owners. This episode ended with the customers of the project releasing an advertisement in a newspaper publicly thanking Alacrity

The customers thanked Alacrity not only for the good housing complex but also for the manner in which it was delivered. Karnad commented, "The publicity and the goodwill that we gained out of this story being told and retold more than justified the expenditure incurred in liquidated damages as an effective advertisement cost."

In another incident, the Chennai Metropolitan Development Authority (CMDA) did not withdraw a 'stop-work order' for a long time. The order was issued misguidedly against one of Alacrity's projects that also affected the processing of its new applications.

Alacrity resolved the problem, by addressing a letter to the Member Secretary of the CMDA (Refer Box for the concluding excerpt of the letter). The maturity and understanding displayed by Alacrity was applauded by the CMDA. A year later, CMDA approached Alacrity to carry out a study for improving the efficiency of its own approval procedures.

Given the general ignorance and apathy of the environment at large, the task of town planning and urban development appears to us to be ambitious in itself. For its successful performance we would require to organise and direct all the available strengths in human resources, irrespective of whether they come from the private sector or government sector. These strengths would include:

- the stringency of the Development Control Rules,
- the procedural discipline of the 'green channel',
- the belief and conviction of honest entrepreneurship,
- and the commitment and enthusiasm of both government authority and private enterprise

Even more important, we believe, it will require an appropriate perspective in implementation which does not allow procedural lapses on either side to develop into a loss of mutual confidence.

By the middle of 1988, Alacrity would have completed more than 40 projects within the city, all of which would manifest the inherent values of the Development Control Rules. The apartments in these projects would have been priced nearly Rs.100/- per square feet less than the price charged by others for comparable quality and service, thereby laying to rest the myth that the Development Control Rules can be observed only at a prohibitive cost to the consumer. If, by then, Alacrity's buildings along with the constructions of other like-minded builders accounted for even 25% of the total area put up by apartment builders in the city the Development Control Rules would be well on the way to gaining popular acceptance During its initial years, Alacrity continuously posted a net loss. In the first year of its operations, Alacrity reported a loss of Rs 42 lakhs. Karnad was surprised as he had followed the principle of moderation. Employee salaries were low and everybody led a fairly simple life style. Karnad called the loss product/ business development cost.

In 1990, Alacrity reported a loss of Rs 32.5 million in its housing business. Though the company's revenues were growing rapidly, productivity had come down considerably. And due to huge losses, the company faced a cash crisis. Since no financial institution was ready to help the company, Alacrity decided to go public. In 1992, Alacrity incorporated Alacrity Housing Ltd., and transferred the ongoing housing business to the latter. In the same year, Alacrity Housing came out with a public issue. Alacrity had a 20% stake in Alacrity Housing Ltd. After the initial public offering, much of Alacrity Housing's financial problems were solved. In the next 2-3 years, Alacrity Housing declared dividends and established itself in the market.

The Indian construction industry was so corrupt that it appeared to be impossible for a construction company to survive without giving bribes and or dealing in black money. The companies

in the industry required large sums of money to purchase property and building materials. In addition, to obtain licenses, they had to deal with corrupt and bureaucratic government officials. Following short cut routes, speeding up processes through bribes, and accepting sub-standard materials seemed to be common practices in the industry.

However, Alacrity Housing felt that it could behave in an ethical manner and still survive in the industry. A strong Gandhian principle seemed to run through Alacrity. The company believed that perseverance and patience were the most important weapons to deal with the corrupt bureaucracy of government departments. Indukanth explained, "If you want to beat the bureaucracy at its own game, there's a very simple rule to follow. Read up and understand their procedures - and you may be sure each government department is governed by detailed do's and don't's. I admit that it takes a little more time, but the effort is worth it." Sharing his experiences of seeking appointments with officials for obtaining clearances, Indukanth said, "The first day, I waited in the queue, having taken an advance appointment and arrived half an hour early. But that day the official left early. I took a fresh appointment, but this time the concerned person did not came to the office. The third time, someone else was let into the room ahead of the rest." Since Indukanth was unable to meet the official after following the government's 'system,' he went into the official's room. He informed the official of his previous experiences and explained that he couldn't wait any longer. Alacrity got the appointment and the permissions. Indukanth explained, "People don't really want to take bribes. It robs them of their dignity and their self-respect. When we deal with someone honestly, although we face difficulties at first, eventually we are the winners, and so are they because they feel good about themselves."

To keep this good feeling and encourage the government departments not to take bribes, Alacrity released series of large advertisements in 1992. The ads were headlined as "It still pays to be honest." The ads named seven government departments that had not taken bribes and issued permissions to Alacrity. These departments had issued about 200 planning and building permits, 1100 sewerage, drainage, water and electricity connections, more than 100 no-objection certificates and 1500 sale deed registrations. It seemed to be a very good corporate strategy. Indukanth said, "Those we mentioned became our supporters in clean dealings."

Alacrity Housing also believed in having fair dealings with customers. They were given detailed information of the house that they planned to buy. The company's booklet - Key Questions to Ask while Buying a Flat - explained the municipal development control rules and formalities. The company prohibited any black money dealings with its customers. In one of its ads, Alacrity applauded and named hundreds of customers who had bought flats without paying in black. The Chief Vigilance Commissioner, Govt. of India said, "Alacrity is an illustrious example among the glorious exceptions of companies observing ethical practices in business. The Urban Land Ceiling Act and the Income Tax Act had ensured that real estate became a gold mine for black money. In that sector, for a company to adopt ethical standards was unbelievable and the fact that they succeeded is really incredible. The question is, if Alacrity can afford to be honest, why not other companies?" The Economic Times[6] also said, "Will Alacrity's example of honest business be replicated elsewhere? ... Actually, making and selling even one flat without black money is a feat in today's India."

In a decade, Alacrity had revolutionized the approach to urban housing and, inspite of difficulties, it seemed to have succeeded in bringing about a sense of organization, discipline and stability in the housing sector. By 1997, Alacrity Housing had emerged as the single largest builder of residential apartments in Chennai, Tamilnadu (Refer Table I, Exhbit III, and Exhibit IV). In the process, it had proved that ethics and economics were not mutually exclusive.

However, one question was uppermost in the minds of critics: Will Alacrity last? An article[7] asked, "How can a company, especially one in an industry as cut-throat as housing construction, survive without underhand payments, bribes and black money dealings?"

However, the founder and the core members of the group were confident that they could continue to follow their corporate philosophy (Refer Table II). They also believed that they could deal with any downturn in the industry. This optimism was reflected in the pledge taken by 31 senior executives of the Alacrity group on its seventeenth anniversary (Refer Exhibit)

Table I Alacrity Housing - 1997 Statistics

Projects	Flats	Area (Sq. Ft)	Value (crores)
Projects Completed			
210	3700	39 lakhs	307
Projects Under Construction			
17	810	7.9 lakhs	98
Projects yet to commence			
22	1248	12 lakhs	217

Source: www.alacrityhomes.com

Table II Alacrity's Corporate Philosophy

The quality of life of an individual is truly enhanced only when the quality of life of the society in which the individual lives is improved
Professional fulfillment for any institution is attainable only when it accepts public accountability for its contribution to social / national causes.
A business mission can be worthwhile and enduring only if it is in line with national goals and priorities.
In the conduct of business integrity - 'not knowingly to do harm' - is the only moral touchstone, and excellence the only performance touchstone.
Business development can be integrated with social/national development only if there is uncompromising respect for laws and regulations and faithful compliance therewith.

Source: www.alacrityhomes.com

2.6 NATIONAL COMMITTEES ON CORPORATE GOVERNANCE

After reading this article you will learn about the recommendations of various National committees on corporate governance.

Committee # 1. CII Code of Desirable Corporate Governance (1998)

For the first time in the history of corporate governance in India, the Confederation of Indian Industry (CII) framed a voluntary code of corporate governance for the listed companies, which is known as CII Code of desirable corporate governance.

The main recommendations of the Code are summarised below:

(a) Any listed company with a turnover of Rs. 1000 million and above should have professionally competent and acclaimed non-executive directors,

who should constitute:

(i) at least 30% of the board, if the chairman of the company is a non-executive director, or

(ii) at least 50% of the board if the chairman and managing director is the same person.

(b) For the non-executive directors to play an important role in corporate decision-making and maximising long-term shareholder value,

They need to:

(i) become active participants in boards, not passive advisors,

(ii) have clearly defined responsibilities within the board, and

(iii) know how to read a balance sheet, profit and loss account, cash flow statements and financial ratios, and have some knowledge of various company laws.

(c) No single person should hold directorships in more than 10 listed companies. This ceiling excludes directorship in subsidiaries (where the group has over 50% equity stake) or associate companies (where the group has over 25% but no more than 50% equity stake).

(d) The full board should meet a minimum of six times a year, preferably at an interval of two months, and each meeting should have agenda items that require at least half-a-days discussion.

(e) As a general rule, one should not re-appoint any non-executive director who has not had the time to attend even one-half of the meetings.

(f) Various key information must be reported to, and placed before the board, viz., annual budgets, quarterly results, internal audit reports, show cause, demand and prosecution notices received, fatal accidents and pollution problem, default in payment of principal and interest to the creditors, inter corporate deposits, joint venture foreign exchange exposures.

(g) Listed companies with either a turnover of over Rs. 1000 million or a paid up capital of Rs. 200 million, whichever is less, should set up audit committees within 2 years. The committee should consist of a least three members, who should have adequate knowledge of finance, accounts, and basic elements of company law. The committees should provide effective supervision of the financial reporting process. The audit committees should periodically interact with statutory auditors and internal auditors to ascertain the quality and veracity of the company's accounts as well as the capability of the auditors themselves.

(h) Consolidation of group accounts should be optional.

(i) Major Indian stock exchanges should generally insist on a compliance certificate, signed by the CEO and the CFO.

Committee # 2. Kumar Mangalam Birla Committee (2000)

Another Committee named as K.M. Birla Committee was set up by SEBI in the year 2000. In fact, this Committee's recommendation culminated in the introduction of Clause 49 of the Listing Agreement to be complied with by all listed companies. Practically most of the recommendations were accepted and included by SEBI in its new Clause 49 of the Listing Agreement in 2000.

The main recommendations of the Committee are:

(a) The board of a company should have an optimum combination of executive and nonexecutive directors with not less than 50% of the board comprising the non-executive directors. In case, a company has a non-executive chairman, at least one-third of board should be comprised of independent directors and in case, a company has an executive chairman, at least half of the board should be independent.

(b) Independent directors are directors who apart from receiving director's remuneration do not have any other material pecuniary relationship or transaction with the company, its promoters, management or subsidiaries, which in the judgement of the board may affect their independence of judgment.

(c) A director should not be a member in more than ten committees or act as chairman of more than five committees across all companies in which he is a director. It should be a mandatory annual requirement for every director to inform the company about the committee positions he occupies in other companies and notify changes as and when they take place.

(d) **The disclosures should be made in the section on corporate governance of the annual report:**

  (i) All elements of remuneration package of all the directors, i.e., salary, benefits, bonus, stock options, pension etc.

  (ii) Details of fixed component and performance linked incentives along with the performance criteria,

  (iii) Service contracts, notice and period, severance fees,

  (iv) Stock option details, if any, and whether issued at a discount as well as the period over which accrued and exercisable.

(e) In case of appointment of a new director or re-appointment of a director, the shareholders must be provided with the information:

  (i) a brief resume of the director,

  (ii) nature of his experience in specific functional areas, and

  (iii) names of companies in which the person also holds the directorship and the membership of committees of the board.

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(f) Board meetings should be held at least four times in a year, with a maximum times gap of 4 months between any two meetings. The minimum information (specified by the committee) should be available to the board.

(g) A qualified and independent audit committee should be set up by the board of the company in order to enhance the credibility of the financial disclosures of a company and promote transparency. The committee should have minimum three members, all being non-executive directors, with majority being independent, and with at least one director having financial and accounting knowledge. The chairman of the committee should be an independent director and he should be present at AGM to answer shareholder queries.

Finance director and head of internal audit and when required, a representative of the external auditor should be present as invitees for the meetings of the audit committee. The committee should meet at least thrice a year. One meeting should be held before finalization of annual accounts and one necessarily every six months. The quorum of the meeting should be either two members or one-third of the members of the committee, whichever is higher and there should be a minimum of two independent directors.

(h) The board should set up a remuneration committee to determine on their behalf and on behalf of the shareholders with agreed terms of reference, the company's policy on specific remuneration package for executive directors including pension rights and any compensation payment. The committee should comprise of at least three directors, all of who should be non-executive directors, the chairman of the committee being an independent director.

(i) A board committee under the chairmanship of a non-executive director should be formed to specifically look into the redressal of shareholder complaints like transfer of shares, non-receipt of balance sheet, declared dividends etc., The committee should focus the attention of the company on shareholders' grievances and sensitize the management of redressal of their grievances,

(j) The companies should be required to give consolidated accounts in respect of all their subsidiaries in which they hold 51% or more of the share capital,

(k) Disclosures must be made by the management to the board relating to all material, financial and commercial transactions, where they have personal interest that may have a potential conflict with the interest of the company at large. All pecuniary relationships or transactions of the non-executive directors should be disclosed in the annual report.

(l) As part of the Directors' Report or as an additional thereto, a management discussion and analysis report should form part of the annual report to the shareholders,

(m) The half-yearly declaration of financial performance including summary of the significant events in last six months should be sent to each household of shareholders,

(n) The company should arrange to obtain a certificate from the auditors of a company regarding compliance of mandatory recommendations and annex the certificate with the Directors' Report, which is sent annually to all the shareholders of the company,

(o) There should be a separate section on corporate governance in the annual reports of companies, with a detailed compliance report on corporate governance.

Committee # 3. Reserve Bank of India (RBI) Report of the Advisory Group on Corporate Governance (2001)

An advisory group on corporate governance under the chairmanship of Dr. R.H. Patil, then Managing Directors, National Stock Exchange was constituted by a standing committee of RBI in 2000. They submitted their report in March 2001, which contained several recommendations on corporate governance.

Committee # 4. Naresh Chandra Committee (2002)

Consequent to the several corporate debacles in the USA in 2001, followed by the stringent enactments of Sarbanes Oxley Act, Government of India appointed Naresh Chandra Committee in 2002 to examine and recommended drastic amendments to the law pertaining to auditor-client relationships and the role of independent directors.

The main recommendations of the Committee are given below:

(a) The minimum board size of all listed companies as well as unlisted public limited companies with paid-up share capital and free reserves of Rs. 100 million and above, or turnover of Rs. 500 million and above, should be seven, of which at least four should be independent directors.

(b) No less than 50% of the board of directors of any listed company as well as unlisted public limited companies with a paid-up share capital and free reserves of Rs. 100 million and above or turnover of Rs. 500 million and above, should consist of independent directors.

(c) **In line with the international best practices, the committee recommended a list of disqualification for audit assignment which included prohibition of:**

(i) Any direct financial interest in the audit client,

(ii) Receiving any loans and/or guarantees,

(iii) Any business relationship,

(iv) Personal relationship by the audit firm, its partners, as well as their direct relatives, prohibition of

(v) Service or cooling off period for a period of at least two years, and

(vi) Undue dependence on an audit client.

(d) **Certain services should not be provided by an audit firm to any audit client, viz.:**

(i) Accounting and book keeping,

(ii) Internal audit,

(iii) Financial information design,

(iv) Actuarial,

(v) Broker, dealer, investment advisor, investment banking,

(vi) Outsourcing,

(vii) Valuation,

(viii) Staff recruitment for the client etc.

(e) The audit partners and at least 50% of the engagement team responsible for the audit of either a listed company, or companies whose paid-up capital and free reserves exceeds Rs. 100 million or companies whose turnover exceeds Rs. 500 million, should be rotated every 5 years.

(f) Before agreeing to be appointed (Section 224 (i)(b)), the audit firm must submit a certificate of independence to the audit committee or to the board of directors of the client company.

(g) There should be a certification on compliance of various aspects regarding corporate governance by the CEO and CFO of a listed company.

It is interesting to note that majority of the recommendations of this committee are the culmination of the provisions of Sarbanes Oxley Act of the USA.

Committee # 5. N.R. Narayana Murthy Committee (2003)

SEBI constituted this Committee under the chairmanship of N.R. Narayana Murthy, chairman and mentor of Infosys, and mandated the Committee to review the performance of corporate governance in India and make appropriate recommendations. The Committee submitted its report in February 2003.

The main items of Committee recommendations are as follows:

(a) Persons should be eligible for the office of non-executive director so long as the term of office did not exceed nine years (in three terms of three years each, running continuously).

(b) The age limit for directors to retire should be decided by companies themselves.

(c) All audit committee members shall be non-executive directors. They should be financially literate and at least one member should have accounting or related financial management expertise.

(d) **Audit committee of listed companies shall review mandatorily the information, viz.:**

(i) Financial statements and draft audit reports,

(ii) Management discussion and analysis of financial condition and operating results,

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(iii) Risk management reports,

(iv) Statutory auditors' letter to management regarding internal control weaknesses, and

(v) Related party transactions.

(e) The audit committee of the parent company shall also review the financial statements, in particular, the investments made by the subsidiary company.

(f) A statement of all transactions with related parties including their bases should be placed before the independent audit committee for formal approval/ratification. Of any transaction is not on an arm's length basis, management should provide an explanation to the audit committee, justifying the same.

(g) Procedures should be in place to inform board members about the risk assessment and minimisation procedures.

(h) Companies raising money through an Initial Public Offering (IPO) shall disclose to the audit committee, the uses/application of funds by major category (capital expenditure, sales and marketing, working capital etc.) on a quarterly basis. On an annual basis, the company shall prepare a statement of funds utilized for purposes other than those stated in the offer document/ prospectus. This statement shall be certified by the independent auditors of the company. The audit committee should make appropriate recommendations to the board to take up steps in this matter.

(i) It should be obligatory for the board of a company to lay down the code of conduct for all board members and senior management of a company. They shall affirm compliance with the code on an annual basis. The annual report of the company shall contain a declaration to this effect signed off by the CEO and COO.

(j) A director to become independent shall satisfy the various conditions laid down by the Committee.

(k) Personnel two observe an unethical or improper practice (not necessarily a violation of law) should be able to approach the audit committee without necessarily informing their supervisors. Companies shall take measures to ensure that this right of access is communicated to all employees through means of internal circulars etc. Companies shall annually affirm that they have not denied any personal access to the audit committee of the company (in respect of matters involving alleged misconduct) and that they have provided protection to whistle blowers from unfair termination and other unfair or prejudicial employment practices. Such affirmation shall form a part of the board report on corporate governance that is required to be prepared and submitted together with the annual report.

(l) For all listed companies there should be a certification by the CEO and CFO confirming, the financial statements as true and fair in compliance with the existing accounting standards, effectiveness of internal control system, disclosure of significant fraud and significant changes in internal control and/or of accounting policies to the auditors and the audit committee. It is worth noting here that majority of the recommendations of this committee have been accepted by SEBI and thereby incorporated in the revised Clause 49 of the Listing Agreement in 2003 and 2004.

Committee # 6. J.J. Irani Committee (2005)

The J.J. Irani Committee was constituted by the Government of India in December, 2004 to evaluate the comments and suggestions received on 'concept paper' and provide recommendations to the Government in making a simplified modern law. The Committee submitted its report to the Government in May 2005, which is under consideration till date.

The main features of its recommendations pertaining to corporate governance are as follows:

(a) The (new) company law should provide for minimum number of directors necessary for various classes of companies. There need not be any limit to the maximum numbers of directors in a company. This should be decided by the companies or by its Articles of Association. Every company should have at least one director resident in India to ensure availability in case of any issue regarding accountability of the board.

(b) Both the managing director as also the whole time directors should not be appointed for more than five years at a time.

(c) No age limit may be prescribed in the law. There should be adequate disclosure of age of the directors in the company's document. In case of a public company, appointment of directors beyond a prescribed age (say) seventy years should be subject to a special resolution passed by the shareholders.

(d) A minimum of one-third of the total strength of the board as independent directors should be adequate, irrespective of whether the chairman is executive or non-executive, independent or not. A director to be independent should satisfy certain conditions laid down by the Committee.

(e) The total number of directorships, any one individual may hold, should be limited to a maximum of fifteen.

(f) Companies should adopt remuneration policies that attract and maintain talented and motivated directors and employees for enhanced performance. However, this should be transparent and based on principles that ensure fairness, reasonableness and accountability. There should be a clear relationship between responsibility and performance vis-a-vis remuneration. The policy underlying directors' remuneration should be articulated, disclosed and understood by investors/ stakeholders.

(g) There need not be any limit prescribed to sitting fees payable to non-executive directors including independent directors. The company with the approval of shareholders may decide on remuneration in the form of sitting fees and/or profit related commissions payable to such directors for attending board and committee meetings, and should disclose it in its director's remuneration report forming part of the annual report of the company.

(h) The requirement of the Companies Act, 1956 to hold a board meeting every three months and at least four meetings in a year should continue. The gap between two board meetings should not exceed four months. Meetings at short notices should be held only to transact emergency business. In such meetings, the mandatory presence of at least one independent director should be required in order to ensure that only well considered decisions are taken. If even one independent director is not present in the emergency meeting, then decisions taken in such meeting should be subject to ratification by at least one independent director.

(i) Majority of the directors of the audit committee should be independent directors if the company is required to appoint independent directors. The chairman of the committee should be independent. At least one member of the audit committee should have knowledge of financial management or audit or accounts. The recommendation of the committee, if overruled by the board should be disclosed in the Directors' Report along with the reasons for overruling.

(j) There should be an obligation on the board of a public listed company to constitute a remuneration committee, comprising non-executive directors including at least one independent director. The chairman of the committee should be an independent director. The committee will determine the company's policy as well as specific remuneration packages for its managing/executive directors/ senior management.

(k) The rights of minority shareholders should be protected during general meetings of the company. There should be extensive use of postal ballot including electronic media to enable shareholders to participate in meetings. Every company should be permitted to transact any item of business through postal ballot, except the items of ordinary business, viz., consideration of annual accounts, reports of directors and auditors, declaration of dividends, appointment of directors, and appointment and fixation of remuneration of the auditors.

(l) All non-audit services may be pre-approved by audit committee. An audit firm should be prohibited from rendering certain non-audit services as specified by the committee,

(m) Public listed companies should be required to have a regime of internal financial controls for their own observance. Internal controls should be certified by the CEO and the CFO of the company and mentioned in the Directors Report.

(n) Detail of transactions of the company with its holding or subsidiary or associate companies in the ordinary course of business and transacted on an arm's length basis should be placed periodically before the board through the audit committee. The transactions not in a normal course of business and/or not on an arm's length justification for the same. A summary of such transaction should form part of the annual report of the company.

(o) Every director should disclose to the company on his directorships and shareholdings in the company and in other companies.

It is important to mention here that despite various recommendations made by the above Committee on corporate governance, the Committee kept silence on two major issues on corporate governance.

They are:

(i) Chairman and CEO duality (particularly in regard to separation of these two posts), and

(ii) Appointment of nomination committee.

2.7 ISSUES IN CORPORATE GOVERNANCE PRACTICES IN INDIA

In the last decade, the frequencies of corporate frauds and governance failures that have dotted the global corporate map have witnessed comparably vigorous efforts of improving corporate governance practices. India has liberalized the regulatory fabric of the country to align its corporate governance norms with those of developed countries. And yet, achieving good governance and ensuring results of such governance practices continue to remain one of the top priorities of stakeholders even today.

Set out below are top ten issues affecting corporate governance practices in India.

1. Getting the Board Right

Enough has been said on board and its role as the cornerstone for good corporate governance. To this end, the law requires a healthy mix of executive and non-executive directors and appointment of at least one woman director for diversity. There is no doubt that a capable, diverse and active board would, to large extent, improve governance standards of a company. The challenge lies in ingraining governance in corporate cultures so that there is improving compliance "in spirit". Most companies' in India tend to only comply on paper; board appointments are still by way of "word of mouth" or fellow board member recommendations. It is common for friends and family of promoters (a uniquely Indian term for founders and controlling shareholders) and management to be appointed as board members. Innovative solutions are the need of the hour – for instance, rating board diversity and governance practices and publishing such results or using performance evaluation as a minimum benchmark for director appointment.

2. Performance Evaluation of Directors

Although performance evaluation of directors has been part of the existing legal framework in India, it caught the regulator's attention recently. In January 2017, SEBI, India's capital markets regulator, released a 'Guidance Note on Board Evaluation'. This note elaborated on different aspects of performance evaluation by laying down the means to identify objectives, different criteria and method of evaluation. For performance evaluation to achieve the desired results on governance practices, there is often a call for results of such evaluation are made public. Having said that, evaluation is always a sensitive subject and public disclosures may run counter-productive. In a peer review situation, to avoid public scrutiny, negative feedback may not be shared. To negate this behavior, the role of independent directors in performance evaluation is key.

3. True Independence of Directors

Independent directors' appointment was supposed to be the biggest corporate governance reform. However, 15 years down the line, independent directors have hardly been able to make the desired impact. The regulator on its part has, time and again, made the norms tighter – introduced comprehensive definition of independent directors, defined a role of the audit committee, etc. However, most Indian promoters design a tick-the-box way out of the regulatory requirements. The independence of such promoter appointed independent directors is questionable as it is unlikely that they will stand-up for minority interests against the promoter. Despite all the governance reforms, the regulator is still found wanting. Perhaps, the focus needs to shift to limiting promoter's powers in matters relating to in independent directors.

4. Removal of Independent Directors

While independent directors have been generally criticised for playing a passive role on the board, instances of independent directors not siding with promoter decisions have not been taken well – they were removed from their position by promoters. Under law, an independent director can be easily removed by promoters or majority shareholders. This inherent conflict has a direct impact on independence. In

fact, earlier this year, even SEBI's International Advisory Board proposed an increase in transparency with regard to appointment and removal of directors. To protect independent directors from vendetta action and confer upon them greater freedom of action, it is imperative to provide for additional checks in the process of their removal – for instance, requiring approval of majority of public shareholders.

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5. Accountability to Stakeholders

Empowerment of independent directors has to be supplemented with greater duties for, and accountability of directors. In this regard, Indian company law, revamped in 2013, mandates that directors owe duties not only towards the company and shareholders but also towards the employees, community and for the protection of environment. Although these general duties have been imposed on all directors, directors including independent directors have been complacent due to lack of enforcement action. To increase accountability, it may be a good idea to require the entire board to be present at general meetings to give stakeholders an opportunity to interact with the board and pose questions.

6. Executive Compensation

Executive compensation is a contentious issue especially when subject to shareholder accountability. Companies have to offer competitive compensation to attract talent. However, such executive compensation needs to stand the test of stakeholders' scrutiny. Presently, under Indian law, the nomination and remuneration committee (a committee of the board comprising of a majority of independent directors) is required to frame a policy on remuneration of key employees. Also, the annual remuneration paid to key executives is required to be made public. Is this enough? To retain and nurture a trustworthy relationship between the shareholders and the executive, companies may consider framing remuneration policies which are transparent and require shareholders' approval.

7. Founders' Control and Succession Planning

In India, founders' ability to control the affairs of the company has the potential of derailing the entire corporate governance system. Unlike developed economies, in India, identity of the founder and the company is often merged. The founders, irrespective of their legal position, continue to exercise significant influence over the key business decisions of companies and fail to acknowledge the need for succession planning. From a governance and business continuity perspective, it is best if founders chalk out a succession plan and implement it. Family owned Indian companies suffer an inherent inhibition to let go of control. The best way to tackle with this is widen the shareholder base - as PE and other institutional investors pump in capital, founders are forced to think about a succession plan and step away with dignity.

8. Risk Management

Today, large businesses are exposed to real-time monitoring by business media and national media houses. Given that the board is only playing an oversight role on the affairs of a company, framing and implementing a risk management policy is necessary. In this context, Indian company law requires the board to include a statement in its report to the shareholders indicating development and implementation of risk management policy for the company. The independent directors are mandated to assess the risk management systems of the company. For a governance model to be effective, a robust risk management policy which spells out key guiding principles and practices for mitigating risks in day-to-day activities is imperative.

9. Privacy and Data Protection

As a key aspect of risk management, privacy and data protection is an important governance issue. In this era of digitalization, a sound understanding of the fundamentals of cyber security must be expected from every director. Good governance will be only achieved if executives are able to engage and understand the specialists in their firm. The board must assess the potential risk of handling data and take steps to ensure such data is protected from potential misuse. The board must invest a reasonable amount of time and money in order ensure the goal of data protection is achieved.

10. Board's Approach to Corporate Social Responsibility (CSR)

India is one of the few countries which has legislated on CSR. Companies meeting specified thresholds are required to constitute a CSR committee from within the board. This committee then frames a CSR policy and recommends spending on CSR activities based on such policy. Companies are required to spend at least 2% of the average net profits of last three financial years. For companies who fail to meet the CSR spend, the boards of such companies are required to disclose reasons for such failure in the

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board's report. During the last year, companies which failed to comply received notices from the ministry of corporate affairs asking for reasons why they did not incur CSR spend and in some cases questioning the reasons disclosed for not spending. In these circumstances, increased effort and seriousness by the board towards CSR is necessary. CSR projects should be managed by board with as much interest and vigour as any other business project of the company.

SUMMARY

This unit summarizes why we require good corporate governance in the country. India provides proper norms and laws aligned with international requirements to govern a corporate. Some of the important reasons are discussed below which raised the need for corporate governance in India.

1. A corporate has a lot of shareholders with different attitudes towards corporate affairs, corporate governance protects the shareholder democracy by implementing it through its code of conduct.
2. Large corporate investors are becoming a challenge to the management of the company because they are influencing the decision of the company. Corporate governance set the code to deal with such situations.
3. Corporate governance is necessary to build public confidence in the corporation which was shaken due to numerous corporate fraud in recent years. It is important for reviving the confidence of investors.
4. Society having greater expectations from corporate, they expect that corporates take care of the environment, pollution, quality of goods and services, sustainable development etc. code to conduct corporate is important to fulfill all these expectations. Takeovers of the corporate entity created lots of problems in the past. It affects the right of various stakeholders in the company. This factor also pushes the need of corporate governance in the country.
5. Globalization made the communication and transport between countries easy and frequent, so many Indian companies are listed with international stock exchange which also triggers the need for corporate governance in India.
6. The huge flow of international capital in Indian companies are also affecting the management of Indian Corporate which require a code of corporate conduct.

QUESTIONS

Conceptual Type

1. What is Current Scenario of CG?
2. What is Nation Committee in CG?
3. What is obligation?
4. What is the Land Mark in India?
5. What is responsibility

Analytical Type

1. What is current scenario of CG ? Discuss its Principles.
2. Discuss about Obligation towards owners or Shareholder.
3. Discuss about obligation towards customers and society.
4. What is the responsibility towards suppliers?
5. Discuss the land mark in India in corporate history?
6. Discuss the National Committees on corporate Governance.

UNIT 3 AGENT AND INSTITUATION

NOTES

Structure

3.1 Shareholder Rights under Companies Act, 2013
3.2 Rights and Privileges of Common Stockholders
3.3 Corporate Governance from the Investor's Perspective
3.4 Corporate Governance: Director, Auditor and Bank
3.5 Role and Responsibility of Board of Directors in Corporate Governance
3.6 Exhibit-Guidelines for Determining Independence of Directors
Summary
Questions

LESSON OUTLINE

- Introduction
- Agent and institution
- Share holder rights under company act 2013
- Rights & principles of common stake holder
- Corporate Governance from investor's perspective
- Director, Auditor& Banks
- Role & Responsibility of Board of Director
- Corporate Governance Guidelines

LEARNING OBJECTIVES

After going through this unit, you will be able to:

- Meaning and Definition of Agent &Institution
- What is the Rights of Share holder
- What is the Rights & Principles of Common Stake Holder?
- What is the Role & Responsibilities of Board of Directors
- What is the Guidelines of Corporate Governanc

INTRODUCTION

Understanding ethical behavior in the context of corporate governance requires two levels that is the internal concerns of corporate agency and the emergent effects on social welfare.

Corporate agency is based on the premise that employees, managers, and directors (i.e., agents) should behave in the best interests of owners or shareholders (i.e., principals). Two things get in the way of that ideal:

First, managers' interests, while overlapping with those of shareholders, are distinct. Sometimes agents can help themselves in ways that hurt the firm and its shareholders. Examples include shirking, waste and, in extreme cases, fraud or other self-serving actions that can bring down the company, as have happened in numerous business scandals.

Second, shareholders have neither the specific knowledge nor skills possessed by management. That can create a dynamic where even well-intentioned managers may feel compelled to "short-termism," i.e., acting in ways that look good to shareholders now, but actually undermine value creation over time. Various oversight, transparency, and incentive mechanisms have evolved, and continue to develop, to contain agency costs.

Social welfare is based on the premise that companies should engage in fair dealing with all of their stakeholders—including customers, employees, suppliers, and communities, as well as shareholders—in accordance with the expectations of the larger society in which they operate. The debate about what is "fair dealing" reflects the larger, ongoing debate about the purpose of corporations in society, but even a shareholder-centric model recognizes that companies benefit from at least nurturing their reputations among all stakeholders, and that minimizing their negative externalities (pollution, plant closures, etc.) preserves the freedom of companies to operate with otherwise minimal external constraints.

While traditional corporations are expected to prioritize shareholder interests above those of other stakeholders and, to a considerable extent, attempt to maximize shareholder value within their legal constraints, other corporate forms permit a more balanced approach between shareholders and vendors (cooperatives).

3.1 SHAREHOLDER RIGHTS UNDER COMPANIES ACT, 2013

Shareholders of a company are the owners of the company owning equity shares issued by the company. Shareholders of a company are granted various rights and protections under the Companies Act, 2013. In this article, we look at those rights.

Changes to MOA or AOA

Memorandum of Association or Articles of Association of a Company can be amended only in a general meeting of the company, which can be convened by providing sufficient notice to the shareholders of the company. All shareholders have a right to vote on amendments relating to changes to MOA or AOA. An affirmative vote of not less than 75% of shareholders is required for some amendments that require special majority.

Convene General Meeting

The Board of Directors of a company is required to convene an extra ordinary general meeting (EGM) if a request to convent a EGM is received from shareholders holding not less than 10% of the paid-up capital of the company. The board is required to call for the EGM within 21 days of the date of request by shareholders on a date not less than 45 days from date of request for EGM. In case the Board of Directors fail to call for a EGM within the time provided, then the shareholders can themselves call for a EGM.

Attend and Vote at General Meeting

All companies are required to hold an annual general meeting every year, with no more than 15 months elapsing between two annual general meetings. All shareholders of a company have a right to receive a notice convening annual general meetings and extraordinary general meetings and to vote at such meetings for or against each of the resolutions proposed to be passed at such meetings.

Transfer Shares

Shareholders of a company have the right to transfer shares held by them in the company freely, except that, the board may refuse to register a transfer of shares if they are not fully paid or where the transferee is not a person approved by the board. A private limited company, however may, by its articles of association, restrict the transfer of shares and provide preemptive rights to its members for purchasing shares proposed to be transferred by the transferee.

Receive Dividends

Dividends can be paid by a company for any financial year out of the profits of the company for that year arrived at after providing for depreciation or out of the profits of the company for any previous financial year or years arrived at after providing for depreciation and remaining undistributed, or out of both. The declaration of dividends is subject to shareholders' approval at an annual general meeting. Once dividends are announced, it must be paid within 30 days and any unpaid dividends must be transferred to a special dividend account opened by the company in a scheduled bank.

Minority Shareholders Protection

In case of oppression or mismanagement of the affairs of the company by majority shareholders, minority shareholders enjoy protection and right to relief from oppression. If 100 or more shareholders, or a number representing not less than 10% of the total number of shareholders, can apply to the Company Law Board if they are of the view that the affairs of the company are being conduced in a manner

prejudicial to the public interest or company's interest or in a manner oppressive to any shareholder. If found fit, the Company Law Board can pass any order it deems fit, including directing majority shareholders to buyout shared held by the oppressed minority

3.2 RIGHTS AND PRIVILEGES OF COMMON STOCKHOLDERS

The common stockholders are the real owners of the company, and as such they have certain rights and privileges. These rights and privileges of common stockholders are established by the term of the charter and laws of the state in which the company is registered. Common stockholders have some specific rights as individual owners. Some important rights are as follows:

1. Right To Share Income And Assets

Common stockholders have the right to share company's earnings equally on a per-share basis. Similarly, in the event of liquidation, stockholders have claim on assets that remain after meeting the obligation to accrued taxes, accrued salary and wages, creditors including bondholders and preferred stockholders. Thus, common stockholders are residual claimants of the firm's income and assets.

2. Control Of The Firm

Common stockholders control the firm through their right to elect the company's board of directors, which appoints management. In a small firm, the largest stockholder typically holds the position of president or chairperson of the board of directors. In a large publicly owned firm, the managers have some stock, but their personal holdings are insufficient to provide voting control. Thus, the shareholders remove the management if they do not perform effectively.

3.Preemptive Right

Preemptive right is a privilege offered to existing shareholders for buying a specified number of shares of the company's stocks before the stocks are offered to outsiders for sale.It is a provision in company's charter or by-laws that gives the existing shareholders right to purchase new shares at a subscribed price on pro-rate basis. Each stockholder receives one right for each share of stock owned. If the company sells new shares to the existing stockholders, it is called right offering.

4. Voting Right

Common stockholders can attend at annual general meeting to cast vote or use a proxy. A proxy is a legal document given one person the authority to cast vote and represent on behalf of others. Generally, each share of stock has one vote for each director at the general meeting. Thus, the owner of 1,000 shares has 1,000 votes for each director to be elected.

3.3 CORPORATE GOVERNANCE FROM THE INVESTOR'S PERSPECTIVE

Corporate governance has always been an important topic. It is even more so today, as many Americans recognize the need to develop a more robust corporate governance regime in the aftermath of the deepest financial crisis since the Great Depression.

Although the recent financial crisis—aptly named the "Great Recession"—has many fathers, there is ample evidence that poor corporate governance, including weak risk management standards at many financial institutions, contributed to the devastation wrought by the crisis. For example, it has been reported that senior executives at both AIG and Merrill Lynch tried to warn their respective management teams of excessive exposure to subprime mortgages, but were rebuffed or ignored. These and other failures of oversight continue to remind us that good corporate governance is essential to the stability of our capital markets and our economy, as well as the protection of investors.

Unfortunately, the important lessons of the recent past are quickly forgotten. For many, the Great Recession, which began in late 2007, is already in the rearview mirror. Last month, the S&P 500 hit record highs, while Wall Street bonuses reached their highest levels since the 2008 crash. In addition, recent reports suggest that retail investors are beginning to return in volume to the stock market.

All of this has taken place even though other reports suggest that there is only tepid confidence in the actual recovery. Many Americans continue to lack trust not only in the stock market, but also in

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financial institutions and the U.S. economy. According to researchers at the University of Chicago, trust in America's financial system languishes at about the 24% level, with many expressing continued concerns regarding both excessive compensation and a lack of integrity among top corporate managers. Only 17% of those surveyed expressed trust in America's large corporations. This is a serious issue, because trust is fundamental to both trade and investment. When there is a lack of trust, both Wall Street and Main Street suffer.

So, how can trust be restored? believe that a key driver of greater trust is the oversight that comes from robust corporate governance..

Investors as Owners and the Source of Capital

It is, after all, investors that provide the capital that businesses need to grow, compete, succeed, and create jobs. They are, in a very real way, the fuel that keeps the engine of our economy moving.

Investors, of course, are not limited to the so-called "one percent." In fact, the vast majority of investors make their livings on Main Street, not Wall Street. They are school teachers and sanitation workers, factory workers and first responders—indeed, anyone with a mutual fund, a pension fund, or a 401(k) plan. About half of all U.S. households participate, either directly or indirectly, in the stock market; and while that percentage is far less than it was during the boom years prior to the financial crisis, it remains true that millions of households invest in stocks, bonds, and mutual funds in order to save for retirement, to put together a down payment on a house, or to pay for their children's college—and law school—education. These hard working Main Street Americans are the investors that need to be kept in mind as we think about corporate governance.

So, what does corporate governance mean for investors? Simply this: it means that the owners of the company are those who have paid to own the company's stock, and that management are merely their employees—albeit often well-paid employees. The separation of ownership and control is the hallmark of the modern corporation. It would be neither possible nor desirable for the many, widely-dispersed shareholders of any public company to come together and manage that company's business and affairs. As a result, full-time management is essential for public companies to operate, and any investor will tell you that talented management is extremely valuable.

But even the most capable management, left unchecked, can make bad decisions, leading to undesirable results for a company and its shareholders. That is why shareholders elect a board of directors to represent their interests. Good corporate governance helps shareholders and their representatives to hire the right managers, and helps make sure that the managers remember they ultimately answer to shareholders. Additionally, good corporate governance also helps to remind the company's directors that they work for the company's shareholders, not for themselves, and certainly not for management.

The exercise of these duties requires the development of a corporate culture, as well as specific processes and practices that promote the fundamental principles of corporate governance.

Accountability

It is particularly fitting that the name of Emory Law School's new journal—*The Emory Corporate Governance and Accountability Review*—makes it clear that accountability is central to effective corporate governance.

Accountability means that actions have consequences. When corporate governance embodies the principle of accountability, shareholders know that performance will be measured. They know that good performance will be rewarded, and poor performance will not. And, most importantly, they know that misconduct will not be tolerated.

Executive Compensation

One important measure of accountability involves executive compensation. Common sense would indicate that good corporate governance should align compensation with performance. However, recent history has to make you wonder if the principle of accountability is lacking in today's corporate governance.

It is well known that the last 30 years have seen rapid growth in the compensation of corporate executives. Much of that growth reflects the trend towards equity-based and other incentive compensation. This form of pay is intended to align the interests of public company shareholders and corporate managers. The concept is straightforward: When stock prices rise, shareholders benefit and managers

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share in the wealth through stock options, appreciation rights, and other awards. In essence, when the companies do well, so do executives. During the boom years, executive pay soared.

But a strange thing has been happening: Many executives have been enjoying the benefits of the pay-for-performance boom, without necessarily delivering increased performance. In fact, the development of the golden parachute has often meant that, in practice, executives have been rewarded handsomely for failure. To give just a few examples, in 2006, Viacom gave roughly $85 million in severance pay to its then CEO after just nine months in the top job. The former CEO of CVS received a severance package worth $185 million when he left in early 2011, even though his company's net earnings had declined the prior year. And last week it was reported that the former chief operating officer of Yahoo! who was fired earlier this year, received about $96 million in compensation for his 15 months on the job, including about $58 million in severance payments. Many other top executives have been shown the door with seven- and eight-figure severance payments. As many commenter's have observed, safety nets of these sizes undermine management incentives from the moment they are granted. When even failure can vastly increase your wealth, you don't need to worry about working hard to be successful. Nor do you need to worry about being accountable.

Say-On-Pay

One important way to enhance accountability is to make sure that shareholders are able to express their views. In 2010, Congress took steps to address this concern in the context of executive compensation, by requiring public companies to give shareholders a voice through so-called "say-on-pay" votes. Specifically, Section 951 of the Dodd-Frank Act requires public companies to conduct shareholder advisory votes to approve the compensation of executives, at least once every three years. In addition, companies soliciting votes to approve merger or acquisition transactions must disclose, and in some circumstances hold a shareholder advisory vote on, any golden parachute compensation arrangements.

In January 2011, the SEC adopted final rules to implement these "say-on-pay" provisions. Although these votes are not directly binding on the corporation, they do nevertheless enhance accountability. Experience demonstrates that corporate boards pay close attention to the voting results and will seek to avoid "no" votes greater than 25-30%. Moreover, early signs suggest that some companies have reacted positively to the "say-on-pay" regime and have begun to re-evaluate compensation packages when pay out-strips performance. As Senator Carl Levin has said, these provisions are intended to "instill a culture of accountability in the executive pay arena." This accountability will be further enhanced when the Commission finalizes its long overdue rules to implement another provision within Section 951 of the Dodd-Frank Act, which requires large investment managers to publicly disclose their "say-on-pay" votes.

Enforcement Actions Relating to Executive Misconduct

An additional way to enhance accountability is by making sure that companies are playing by the rules. While this is true as to many issues, it is particularly troubling when management is willing to break the law to boost their paychecks. For example, in the last decade, some companies secretly backdated stock options to give executives and other employees the benefits of favorable stock price movements. Others manipulated exercise dates so that executives could profit unfairly at the expense of the corporation and its shareholders.

The SEC has pursued such cases aggressively, charging dozens of public companies and their executives with fraud and reporting violations. Sadly, many of the individual defendants who participated in such schemes were company general counsels and other lawyers, who should have known better—and clearly should have done better.

Commission enforcement actions are a key mechanism for imposing accountability on corporate officers and gatekeepers. This is particularly important when self-dealing or other breaches of duty result in violations of the Commission's rules regarding fraud, reporting requirements, books and records, or financial controls. When such violations occur, the Commission has a number of tools at its disposal, including the ability to seek disgorgement of ill-gotten gains, to impose civil penalties, and to bar wrongdoers from serving as a public company officer or director.

A robust enforcement program helps to reinforce the principle of accountability by punishing those in a position of trust and responsibility who cross the line.

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Transparency

A second principle of corporate governance is transparency. Without transparency, it is difficult to have accountability. After all, shareholders can only hold corporate directors accountable if they know what is going on at the companies they own.

The Commission promotes this principle of transparency by requiring that public companies shine a light on the information that investors need to make good investment and voting decisions. In this regard, the Commission's rules require public disclosure of various types of information, including descriptions of a company's business, its board and management, and financial and operating data, both historical and forward-looking. The access to audited financial information and other required public disclosures is particularly important when it comes to shareholders holding officers and directors responsible for corporate performance.

One of the important ways that the Commission mandates public disclosure is through the proxy process, which is intended to duplicate what would happen in an "in-person" meeting of shareholders. The proxy disclosure regime is an evolving process that takes into account the needs of investors, changes in the markets, and the Commission's own experience.

It should be no surprise that investors have a strong interest in knowing about how their companies are doing and the decisions that are being made. This is also true as to matters involving executive compensation. After all, at the end of the day, it is the shareholder that pays the CEO's salary. The question is, how can the average shareholder tell if she's gotten her money's worth?

To help answer that question, over the years the Commission has periodically amended its disclosure rules. For example, in 2006, the Commission amended the proxy rules to help provide investors with a clearer and more complete picture of total compensation for the chief executive, other highly-paid executive officers, and directors. And in 2009, the Commission responded to lessons learned from the financial crisis by significantly enhancing proxy statement disclosures with respect to corporate governance and executive compensation. Noting an increased focus by investors on corporate accountability, the Commission adopted new disclosure requirements regarding risk management and compensation matters, including improvements to the reporting of stock and option awards, disclosure regarding potential conflicts of interest of compensation consultants, and a requirement to discuss how compensation policies and practices may incentivize risk-taking.

All of these disclosures enhance transparency.

Disclosure Rules Relating to Executive Compensation

Moreover, in Title IX of the Dodd-Frank Act, Congress has mandated that the Commission adopt rules to address a number of new compensation-related disclosures. These include disclosures as to:

- the relationship between executive compensation actually paid and the financial performance of the issuer;
- company policies regarding the hedging of equity securities held or awarded to directors and employees; and
- the ratio between the compensation of the chief executive officer and the total annual compensation of its average worker (known as "Pay Ratio").

Last September, the Commission took an important step to fulfill the Congressional mandate by proposing the Pay Ratio rule. As mentioned earlier, in recent decades, the compensation of corporate executives has taken an explosive upward trend. In fact, reports demonstrate that the compensation growth of public company CEOs has far outpaced the growth in salaries of the typical employee over the years. For example, an April 2013 study by Bloomberg finds that large public company CEOs were paid an average of 204 times the compensation of rank-and-file workers in their industries. By comparison, in the 1950s, it is estimated that the average CEO was paid only about 20 times the typical worker's pay, with that multiple rising to 42-to-1 in 1980, and to 120-to-1 in 2000. Hopefully, disclosing Pay Ratios will help investors evaluate the reasonableness of a CEO's compensation in the context of a company's overall business, provide insight into the effectiveness of board oversight, and offset the upward bias in executive pay that seems to result from benchmarking a CEO's compensation only against the compensation of other CEOs.

The Commission has received an extraordinary number of comment letters regarding the Pay Ratio proposal, most of which have been strongly supportive. I hope and expect that the Commission will move quickly to adopt a final rule this year.

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I also urge the Commission to adopt rules requiring the mandated pay-for-performance and hedging disclosures. Taken together with the Pay Ratio rule, these enhanced disclosures will foster accountability by making compensation decisions more transparent, and will help investors to make more informed investment decisions when they exercise their rights as shareholders and owners.

Engagement

A third principle of corporate governance is engagement. By this I mean that shareholders need a way to make sure that their voices are heard.

Traditionally, the primary opportunity for shareholders to communicate with directors and management takes place once a year at the Annual Meeting of Shareholders. However, for most shareholders, it is simply not practical to attend the annual meeting.

As a result, shareholders have long complained that more engagement was needed for them to exercise their rights as owners of the company and have pointed out the difficulty of communicating with directors and management. So, how can companies committed to good corporate governance fill that gap? And what can security holders do proactively to protect their rights?

Informal Engagement

To address shareholder concerns, many public companies have recently increased their efforts to engage with shareholders—and have become more proactive in investor relations. In fact, one proxy solicitation firm has characterized the current period as “The Era of Engagement.” It wasn’t so long ago that a large public company could make news by saying that it would meet regularly with investors to discuss executive pay and management practices. However, shareholder-management meetings and other forms of engagement have increased dramatically in recent years. A study that came out in 2011 indicated that 87% of the issuers, 70% of the asset managers, and 62% of the pension funds and other investors surveyed reported at least one engagement over the preceding year, with most respondents saying that shareholder-company contact was occurring more frequently.

There are many reasons for the reported increase in shareholder involvement. Some observers credit the role of proxy advisory firms, which they say have helped investors to magnify their influence. Others cite the adoption of “say-on-pay” rules, which provided both a forum for investors to demonstrate their concerns regarding executive pay and other governance issues, as well as a clearly-defined metric of investor sentiment, as evidenced by approval rates. For example, shortly after Johnson & Johnson received a weak 57% approval rate for its “say-on-pay” proposal in 2012, the company’s compensation and benefits committee chair and presiding director, along with several executives, met with representatives of many of the company’s institutional investors to discuss their concerns.

As an advocate for investors, I am gratified by these indications of responsiveness on the part of many public company boards, but let us not confuse activity with progress. According to a 2011 report, management is much more likely than investors to consider such outreach a success. It’s one thing to start a dialogue; but it’s quite another thing entirely to change behavior. Investors need concrete action to enhance accountability, pay-for-performance, and other goals—not just words.

Moreover, this type of engagement is focused almost entirely on institutional investors—and, in many cases, only the largest of these. Small investors that own shares directly are typically frozen out of the process. That’s a problem because, often times, the interests of Main Street and Wall Street are not aligned.

Engaging Retail Shareholders

One obstacle to promoting engagement by retail shareholders is that individual shareholders often tend to be passive investors. For example, last year, retail investors voted only 30% of their public company shares, as compared to institutional investors, which voted 90% of their shares.

One innovation that has the potential to increase engagement by retail shareholders is the use of electronic shareholder forums. To that end, in January 2008, the Commission adopted rules to facilitate

the use of this tool by public companies and their shareholders. The intent was to facilitate shareholder communications and uphold shareholder rights by encouraging experimentation, innovation, and greater use of the Internet. Unfortunately, however, reports suggest that only a small minority of U.S. domestic issuers take advantage of this innovation. The Commission should investigate this and determine whether our rules should be amended.

Shareholder Proposals

Another way that investors may seek to communicate with directors, management, and each other is by submitting shareholder proposals for consideration at the annual meeting. Long-standing SEC rules address when a company is required to include a shareholder proposal in its proxy materials. Generally, these rules include both substantive and procedural requirements, and shareholders must also meet certain eligibility rules.

In recent years, common topics for shareholder proposals have included executive compensation, environmental issues, majority voting for directors, and eliminating classified boards. This year, some observers expect "proxy access" to be a popular topic—that is, proposals to establish a procedure that would allow shareholder director nominees to be included in company proxy materials.

Both companies and shareholders have used the shareholder proposal process as an occasion to engage with one another. Last year, for example, it was reported that the management of JPMorgan Chase & Co. actively lobbied institutional investors to oppose a shareholder proposal seeking to separate the CEO and board chairman roles at the bank. Supporters of the proposal also took their arguments directly to investors, including meetings with substantial shareholders. Although in this case management defeated the shareholder proposal, campaigns like these—which are becoming more and more common—underscore the impact that shareholder proposals can have on corporate governance matters. Notably, during the 2013 proxy season, individual shareholders sponsored 49% of all shareholder proposals (up from less than 41% in 2012), as compared to about 16% for public pension plans (down from 21% in 2012), and about 26% for labor unions (about the same as the prior year). Experience shows that the shareholder proposal process can be an effective tool to amplify the voice of individual shareholders in corporate governance. In fact, often an issue raised through the shareholder proposal process is addressed through negotiations between management and the proposing shareholder, making the inclusion of a shareholder proposal in the final proxy statement unnecessary.

In that regard, it has been reported that companies received over 750 shareholder resolutions with respect to the 2013 proxy season. Although few of these resolutions may actually be approved by vote at a meeting, each provides an opportunity for engagement so that investors can have their views heard and have an impact on corporate governance.

In the end, whatever the mechanism—shareholder proposals, shareholder forums, or "in-person" meetings—it is important that shareholders be able to communicate with their companies. I firmly believe that companies with corporate governance processes that enhance how they engage with their owners will be more successful than those that keep the doors shut.

3.4 CORPORATE GOVERNANCE: DIRECTOR, AUDITOR AND BANK

Introduction

Corporate governance had gain popularity nowadays specially after the collapses of many companies who appeared giant and efficient while actually they were fragile. Expropriation of stakeholders by senior managers is widely evident with the collapses of companies such as Enron which is symbolic of shareholders failure to protect their interests due to asymmetrical information and conflict of interest in board of directors. The inefficiency of corporate governance mechanisms in banks and financial institutions are blamed in each crises. However, after absorbing the impact of failure, many opinions call for re-designing corporate governance mechanisms to ensure board responsibility and accountability, risk management, transparency and disclosure in financial reports. Despite the negative impact of Enron collapse, the case "has done for reflection on corporate governance what AIDS did for research on the immune system". The ties between executive managers and shareholders were destroyed because of manager's greed and willingness to benefit themselves over shareholders interest. Although shareholders should be supported by board and have a special position in the front line of interest to managers as providers of capital, sometimes board of directors do not choose to act and other times.

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Boards of Directors often conspired with the executives (because the executives and their friends sat on the Board, controlling the agenda and directing important committees), or failed to exercise sufficient diligence in monitoring the executives; the shareholders, especially large institutional shareholders, paid insufficient attention to the quality of the Boards and to the reports of external auditors.

According to stakeholders' theory, managers should make decisions that are in the best interest of stakeholders. However, Jensen [2] criticizes the ability of managers to satisfy all stakeholders at the same time and in this case the theory is "unassailable". As when a manager is trying to maximize shareholders wealth, current profits, market share, future growth in profits can destroy his ability to take the right decision. As "A manager directed to maximize both profit and market share has no way to decide where to be in the range between maximum profits and maximum market share". Managers under the supervision of the board should take all different dimensions in mind for the well-being of the firm and welfare of society. It is necessary to have internal control system to limit managerial actions.

Because stakeholder theory provides no criteria for what is better or what is worse, it leaves boards of directors and executives in firms with no principled criterion for problem solving … it leaves managers and directors unaccountable for their stewardship of the firm's resources. With no criteria for performance, managers cannot be evaluated in any principled way. Therefore, stakeholder theory plays into the hands of self-interested managers allowing them to pursue their own interests at the expense of society and the firm's financial claimants.

The size and magnitude of Enron's failure challenges academic beliefs about corporate governance and the role that could be played by board of directors, external auditors in constraining executive managers from going too far, destroying companies and creating losses to stakeholders. The aligning of manager's interests with stakeholder's interests needs more solid foundations other than assuming that it is easily being aligned. Enron highlighted the way in which loose regulations had led auditors to allow accounting methods that promote overstating profits while analysts remained positive and sometimes silent in spite of un-logical financial results. The changes in executive compensation in the 1990s in USA, designed to align executive interests with those of shareholders, provided a strong incentive to managers to overstate earnings, even if this was not sustainable and illusionary. When chief executive officers spend three to four years in companies and cash their stock options and then markets are not quick to respond then stakeholders face the consequences .

Board of directors should play different roles in organizations in order to maintain their sustainability. They have to plan strategic direction, advising, active monitoring and disciplining roles. Also the board should control the process of appointing executives and assessing their actions. Adams et al.

Assessment can be seen as having two components, one is monitoring of what top management does and the other is determining the intrinsic ability of top management. The monitoring of managerial actions can, in part, be seen as part of a board's obligation to be vigilant against managerial malfeasance. Yet, being realistic, it is difficult to see a board actually being in a position to detect managerial malfeasance directly; at best, a board would seem dependent on the actions of outside auditors, regulators, and, in some instances, the news media. Indirectly, a board might guard against managerial malfeasance through its choice of auditor, its oversight over reporting requirements, and its control over accounting practices.

3.5 ROLE AND RESPONSIBILITY OF BOARD OF DIRECTORS IN CORPORATE GOVERNANCE

In many countries shareholders have a dominant role in appointing board of directors. Shareholders believe that appointed board and senior managers will act in their interests. Senior managers are responsible of directing; planning and controlling work and take corrective actions necessary. They should manage risk, have appropriate control systems, provide accurate information and act ethically. Shareholders place their trust in board's decisions in supervising senior manager's actions and proficiency. However, in many incidents this is not the case and agency problem persist. When existing and potential investors are considering buying or selling stocks of any companies, they often rely on financial information which is not forward looking, subjective and sometimes incorrect. In this case, shareholders confidence

for an effective role and responsibilities of the board in supervising and selecting senior managers is crucial. In order for corporate governance to function efficiently, several dimensions might be taken into consideration including role and responsibilities of the board, board composition, management process, relationship between board members, and duality of CEO and Chairman .

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Corporate governance can be viewed as a nexus of relations between board of directors, company management, shareholders, debt holders, customers, government and other stakeholders within a social, legal and political framework. The effectiveness of corporate governance flourishes in an environment of compliance, transparency and accountability. Board of directors has a control, strategic and resource provision roles the supervisory board "can help the firm connect with the relevant segments and environmental constituencies". Isik and Ince argued that board of directors is a cornerstone in the governance mechanism. They explored the relationship between board size and board composition on performance for a sample of 30 commercial banks from 2008 to 2012 in Turkey. They measured banks performance by operating return on assets and return on assets. Their findings showed that board size has a significantly positive effect on bank's financial performance while there is no significant relationship between for the percentage of outside directors on banks' financial performance. Different critical areas should be taken into consideration by the board such as emphasizing ethical values, standards in the work environment and overseeing strategies that address sustainability and stakeholder interests. Bernardi and Lacross surveyed a sample of quarter of Fortune 500 companies in order to explore their concern about publishing their codes of ethics. They discovered that since the collapse of Enron in 2002, companies generally give increasing emphasis to the code of ethics, which can be seen as a positive sign. There were also no significant differences in the disclosure rates between different industries. One astonishing finding was that in 2002 none of the former companies audited by Arthur Andersen revealed ethics policies on their websites. Fung states:

Corporate governance highlights the important principles of oversight and control over the executive management's performance and strategic directions; and their accountability to the shareholders. A code of ethics, which clarifies and stipulates adherence to some of more abstract ideals of trust and accountability, is essential for good corporate governance. The board and management should endeavor to uphold and nurture accountability, transparency, fairness, and integrity in all aspects of the company operations.

Onto argued that two agency problems exists one where the board is the agent for shareholders and at the same time assumed to be principal to directors. It monitors management on behalf of its principals – shareholders, and trying to monitor and deduct managerial inefficiency and abuse. Sometimes managers have power over the board as it manifested in Enron.

A board's independence depends on a bargaining game between the board and the CEO of the many responsible parties implicated in Enron's scandal, it could be said that the board's inactions, up to a certain extent, led the company to its demise in December 2001. Enron's board approved a disclosure policy that made the firm's financial results substantially opaque to public capital markets. It also approved a compensation strategy that made managerial payoffs highly sensitive to stock price changes and it also failed to engage in an intense monitoring of business results and financial controls.

The roles and responsibilities of a Board of directors are different, depending on the nature and type of organization and the laws applied in a certain country. Similarly, the establishment of different committees is a means to channel the functions of a board into expertise groups of directors that focus on specific issues in organization. The role of the board is critical for the success of companies. According to UK Corporate Governance Code , the board should make sure that financial and human are available to fulfil companies objectives. They board is responsible for making sure an amalgam of skills and experience in the board for running companies smoothly and efficiently . In Saudi Arabia, The General Department of Finance is in charge of controlling the financial sector and has the authority to supervise the activities of finance companies according to Finance Companies Control Law. Although rules and regulations are available, monitoring implementation is necessary when managers and board try to manipulate it .

Financial Institution and Board Responsibilities

Corporate governance regulation has been issued by Capital Market Authority (CMA) in November 2006, in response for Saudi Stock market crash. However, corporate governance in Saudi Arabia is still a fairly new concept, the Saudi Arabian Monetary Agency (SAMA) and Capital Market Authority (CMA)

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are still in the process of organizing the financial markets and highlighting the benefits of applying good corporate governance and many of the laws and institutions are still relatively new with little experience; awareness of the importance of good corporate governance is low, and implementation by companies is in its early stages.

The Saudi Arabian Monetary Agency (SAMA), the central bank of the Kingdom of Saudi Arabia, has been entrusted with performing many functions. The most important two of those functions are: licensing financial institutions to operate in the kingdom financial sector and supervise those finance institutions' activities in accordance with the rules and regulations:

Corporate Governance Guidelines

The following corporate governance guidelines of the Board of Directors of the Company, have been approved by the Board of Directors and provide the framework for the corporate governance of the Company.

Role of the Board of Directors

The Company's business is managed under the direction of the Board of Directors. The Board delegates to the Chief Executive Officer, and through that individual to other senior management, the authority and responsibility for managing the Company's business. The Board's role is to oversee the management and governance of the Company and to monitor senior management's performance.

Among the Board's core responsibilities are to:

- Select individuals for Board membership and evaluate the performance of the Board, Board committees and individual directors.
- Select, monitor, evaluate and compensate senior management.
- Assure that management succession planning is adequate.
- Review and approve significant corporate actions.
- Review and monitor implementation of management's strategic plans.
- Review and approve the Company's annual operating plans and budgets.
- Monitor corporate performance and evaluate results compared to the strategic plans and other long-range goals.
- Review the Company's financial controls and reporting systems.
- Review and approve the Company's financial statements and financial reporting.
- Review the Company's ethical standards and legal compliance programs and procedures.
- Oversee the Company's management of enterprise risk.
- Monitor relations with shareholders, employees, and the communities in which the Company operates.

Board size and Composition

The Board of Directors is comprised of such number of directors as the Board deems appropriate to function efficiently as a body, subject to the Company's Articles of Association. The Corporate Governance and Nominating Committee reviews the composition of the full Board to identify the qualifications and areas of expertise needed to further enhance the composition of the Board, makes recommendations to the Board concerning the appropriate size and needs of the Board and, on its own or with the assistance of management or others, identifies candidates with those qualifications.

The Board is made up of a substantial majority of independent, non-employee directors and the Board considers this to be the appropriate structure. The Board establishes principles and procedures to determine whether or not any particular director is independent in accordance with applicable regulations and the requirements of the New York Stock Exchange. The standards currently in effect for determining the independence of individual directors are attached as Exhibit I to these Corporate Governance Guidelines.

Selection of Directors

Under the Articles of Association, the Board of Directors has authority to fill vacancies in the Board and appoint additional directors (in each case subject to their re-election at the next annual general meeting)

and to nominate candidates for election by the shareholders. The screening process is done by the Corporate Governance and Nominating Committee with direct input from the Chairman and CEO and from the other directors and from time to time with the assistance of director search firms. In considering candidates for director, the Corporate Governance and Nominating Committee will take into account all factors it considers appropriate, including, among other things, breadth of experience, understanding of business and financial issues, ability to exercise sound judgment, diversity, leadership, and achievements and experience in matters affecting business and industry. The Corporate Governance and Nominating Committee considers the entirety of each candidate's credentials and believes that at a minimum each nominee should satisfy the following criteria: highest character and integrity, experience and understanding of strategy and policy-setting, sufficient time to devote to Board matters, and no conflict of interest that would interfere with performance as a director. Shareholders may recommend candidates for Board membership for consideration by the Corporate Governance and Nominating Committee. Such recommendations should be sent to the Committee, care of the Secretary of the Company. Candidates recommended by shareholders are evaluated in the same manner as director candidates identified by any other means.

Chairman of the Board and CEO

The positions of Chairman of the Board and CEO are held by the same person, except in unusual circumstances, such as during a CEO transition. This policy has worked well for the Company. It is the Board's view that the Company's corporate governance principles, the quality, stature and substantive business knowledge of the members of the Board of Directors, as well as the Board's culture of open communication with the CEO and senior management are conducive to Board effectiveness with a combined Chairman and CEO position.

Lead Director

It is the policy of the Board that a Lead Director be appointed for a three-year minimum term from among the Company's independent directors. The Lead Director shall have the roles and responsibilities set forth in Exhibit II to these Corporate Governance Guidelines

The Board of Directors has the following committees: Audit, Compensation, Corporate Governance and Nominating, Finance, Technology and Innovation and Executive. All committees have written, Board-approved charters detailing their responsibilities and the extent to which they have been delegated powers of the Board of Directors. Only non-employee directors serve on the Audit, Compensation, Corporate Governance and Nominating, Finance and Technology and Innovation Committees. Chairpersons and members of these five committees are rotated periodically, as appropriate. The Chairman, who is also the CEO, serves on the Company's Executive Committee and is Chairperson of such Committee. The remainder of the Executive Committee is comprised of the non-employee director Chairpersons of the Audit, Compensation, Corporate Governance and Nominating and Finance Committees. At each meeting of the Audit Committee, committee members meet privately with representatives of the Company's independent auditors, and with the Company vice president responsible for the internal audit function. At least once a year, the Audit Committee meets privately with the Company's chief compliance officer.

The Audit Committee meets at least five times each year, and the Compensation, Corporate Governance and Nominating and Finance Committees each meet at least four times each year, and the Technology and Innovation Committee meets at least once a year. The Executive Committee meets on an as needed basis when directed by the Chairman or Lead Director. Additional committee meetings are called as required.

Board Agenda and Meetings

The Chairman establishes the agendas for the Board meetings in conjunction with the Lead Director. Each director is free to suggest items for inclusion in the agenda, and each director is free to raise at any Board meeting subjects that are not on the agenda for that meeting. Board materials relating to agenda items are provided to Board members in advance of meetings to allow the directors to prepare for discussion of matters at the meeting. The Board reviews and approves the Company's yearly operating plan and specific financial goals at the start of each year, and the Board monitors performance throughout the year. At an expanded Board meeting once a year, the Board reviews in depth the Company's long-range strategic plan. At the expanded meeting, it also reviews senior management development and succession planning.

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Management presentations are made to the Board and its committees regularly on various aspects of the Company's operations. The directors have unrestricted access to management and corporate staff.

Executive sessions of Non-employee Directors

The non-employee directors meet privately in executive sessions to review the performance of the CEO and to review recommendations of the Compensation Committee concerning compensation for the employee directors. The non-employee directors also meet as necessary, but at least twice a year, in executive session to consider such matters as they deem appropriate without management being present.

Director orientation and Continuing Education

In order to become familiar with the Company, as well as the functioning of the Board of Directors, newly-appointed directors receive a variety of materials, including a Directors' Handbook, which provide an overview of the Company, its operations and organization. They are also provided with access to key management personnel to provide additional information, including significant issues currently facing the Company. Management will also maintain a program to keep directors up to date on legal, regulatory and other matters relevant to their positions as directors of a large publicly-held corporation.

Director Compensation and Stock ownership

The Corporate Governance and Nominating Committee periodically reviews the Board of Directors' compensation and benefits and compares them with director compensation and benefits at peer companies. It is the Board of Directors' policy that directors be required to acquire shares of Company stock worth five times the annual cash retainer. A director cannot sell any shares of Company stock until he or she attains such level of ownership and any sale thereafter cannot reduce the total number of holdings below the required share ownership level. Directors are required to retain this minimum level of Company stock ownership until their resignation or retirement from the Board. It is also the policy of the Board that directors' fees be the sole compensation received from the Company by any non-employee director.

CEO Performance Evaluation

At the beginning of each year, the CEO presents his or her performance objectives for the upcoming year to the non-employee directors for their approval. At the end of the year, the non-employee directors then meet privately to discuss the CEO's performance for the current year against his or her performance objectives. The non-employee directors use this performance evaluation in the course of their deliberations when considering the compensation of the CEO. The non-employee directors and the CEO then meet to review the CEO's performance evaluation and compensation.

Chief Executive Officer Succession

The Board of Directors views CEO selection as one of its most important responsibilities. To assist the Board in succession planning, the CEO reports at least annually to the Board providing an assessment of senior managers and their potential to succeed the CEO, either in the event of a sudden emergency or in anticipation of the CEO's future retirement.

Director Retirement

Each non-employee director must retire at the annual general meeting immediately following his or her 75th birthday. Directors who change the occupation they held when initially elected must offer to resign from the Board. At that time, the Corporate Governance and Nominating Committee reviews the continued appropriateness of Board membership under the new circumstances and makes a recommendation to the Board. Employee directors, including the CEO, must retire from the Board at the time of a change in their status as an officer of the Company, unless the policy is waived by the Board.

Board and Board Committee Performance Evaluation

With the goal of increasing the effectiveness of the Board of Directors and its relationship to management, the Corporate Governance and Nominating Committee assists the Board in evaluating its performance as a whole and the performance of its committees. Each Board committee is also responsible for conducting an annual evaluation of its performance. The effectiveness and contributions of individual directors are considered each year when the directors stand for recombination.

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Board Memberships

The CEO and other members of senior management must seek the approval of the Board (or the Board committee to which this responsibility has been delegated), before accepting outside board memberships with for-profit entities.

Non-employee directors must advise the Chairman of the Board and the Chair of the Corporate Governance and Nominating Committee if they are being considered for election or appointment to a board of directors of another publicly-held company. The Corporate Governance and Nominating Committee will determine whether the new board membership is compatible with continued service on the Company's Board. It is the policy of the Board that non-executive directors may not serve on the board of more than four other publicly held companies without the prior approval of the Board of Directors, except that any new board members shall be given a reasonable transition period to come into compliance with the policy.

Independent Advice

The Board or a committee of the Board may seek legal or other expert advice from a source independent of management. Generally, this would be with the knowledge of the CEO.

Code of Conduct

The Company will maintain a code of business conduct and ethics which will articulate for employees, shareholders, customers and suppliers the standards of conduct, including conflicts of interest matters, to which the Company expects to adhere. Directors will also be required to abide by the code of conduct. Any waivers of the conflict of interest requirements of such code in favor of a director or executive officer will be subject to approval by the Board. In the case of the consideration of such a waiver in favor of a director, such director shall not participate in the deliberation or vote relating to such waiver.

Internal Audit Function

The Company will maintain an internal audit function whose head will report directly to the Audit Committee. The internal audit function is responsible for bringing a systematic, disciplined approach to evaluate the effectiveness of risk management, control and governance processes. Its duties include monitoring the compliance by Company operations with the Company's internal controls and identifying any deficiencies in the design or operation of such internal controls which could adversely affect the Company's ability to record, process, summarize and report financial data.

3.6 EXHIBIT-GUIDELINES FOR DETERMINING INDEPENDENCE OF DIRECTORS

(A) A director will not be deemed "independent" if: (i) the director is affirmatively determined by the board of directors of the Company to have a material relationship to the Company (either directly or as a partner, shareholder or officer of an organization that has a relationship with the Company); (ii) the director is or was within the last three years employed by the Company or any of its subsidiaries; (iii) an immediate family member of the director is or was within the last three years employed by the Company or any of its subsidiaries as an executive officer; (iv) the director or an immediate family member of the director has received during any twelve-month period within the last three years more than $120,000 in direct compensation (other than director and Board committee fees and pension or other forms of deferred compensation not contingent on continued service as a director from the Company and its subsidiaries), provided, however that for purposes of this subparagraph (iv), compensation received by an immediate family member for service as an employee of the Company (other than an executive officer) shall not be included in determining a director's independence; (v) the director, or an immediate family member of the director, is a current partner of a firm that is the Company's internal or external auditor; (vi) the director is a current employee of such audit firm; (vii) an immediate family member of the director is a current employee of such audit firm and personally works on the Company's audit; (viii) the director or an immediate family member of the director was within the last three years (but is no longer) a partner or employee of such audit firm and personally worked on the Company's audit within that time; (ix) an executive officer of the Company is or was within the last three years on the compensation committee of the board of directors of a company that employed the director, or an

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immediate family member of the director, as an executive officer at the same time; or (x) the director is a current employee, or has an immediate family member who is a current executive officer, of a company or tax exempt organization having any of the relationships with the Company described in paragraph (B) below.

(B) The following commercial or charitable relationships are considered to be material relationships that would impair a director's independence: (i) if a director is a current employee, or an immediate family member of a director is a current executive officer, of another company that has made payments to, or receives payments from, the Company for property or services in an amount which, in any of the last three fiscal years, exceeds the greater of $1 million, or 2% of the other company's consolidated gross revenues or (ii) if a director is a current employee, or an immediate family member of a director is a current executive officer, of a tax exempt organization, and the Company's discretionary charitable contributions to the organization in the aggregate are greater than $1 million, or 2% of that organization's consolidated gross revenues. (The amount of any "match" of charitable contributions under the Company's matching gifts program will not be included in calculating the amount of the Company's contributions for this purpose.) The Board will annually review all commercial and charitable relationships of directors.

(C) For relationships other than those of the types described in (A) and (B), the determination of whether the director has a material relationship with the Company, and therefore may not be independent, will be made in good faith by the directors who satisfy the guidelines set forth in such preceding paragraphs.

(D) For purposes of these guidelines the term "immediate family member" includes an individual's spouse, parents, children, siblings, mothers and fathers-in-law, sons and daughters-in-law, brothers and sisters-in-law and anyone (other than domestic employees) who shares such individual's house.

(E) For purposes of these guidelines the term "executive officer" shall have the same meaning as the term "officer" in Rule 16a-1(f) of the Securities Exchange Act of 1934.

Exhibit II- Ingersoll-Rand PCL Lead Director Board Role

The Lead Director coordinates the activities of all of the Board's independent directors. The Lead Director is the principal confidant to the CEO and ensures that the Board has an open, trustful relationship with the Company's senior management team. In addition to the duties of all Directors, as set forth in the Company's Governance Guidelines, the specific responsibilities of the Lead Director are as follows:

- Chair the meetings of the independent directors when the Chairman is not present;
- Ensure the full participation and engagement of all Board members in deliberations;
- Lead the Board in all deliberations involving the CEO's employment, including hiring, contract negotiations, performance evaluations, and dismissal;
- Counsel the Chairman on issues of interest/concern to directors and encourage all directors to engage the Chairman with their interests and concerns;
- Work with the Chairman to develop an appropriate schedule of Board meetings and approve such schedule, to ensure that the directors have sufficient time for discussion of all agenda items, while not interfering with the flow of Company operations;
- Work with the Chairman to develop the Board and Committee agendas and approve the final agendas;
- Keep abreast of key Company activities and advise the Chairman as to the quality, quantity and timeliness of the flow of information from Company management that is necessary for the directors to effectively and responsibly perform their duties; although Company management is responsible for the preparation of materials for the Board, the Lead Director will approve information provided to the Board and may specifically request the inclusion of certain material;
- Engage consultants who report directly to the Board and assist in recommending consultants that work directly for Board Committees;
- Work in conjunction with the Corporate Governance and Nominating Committee in compliance with Governance Committee processes to interview all Board candidates and make recommendations to the Board;

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- Assist the Board and Company officers in assuring compliance with and implementation of the Company's Governance Guidelines; work in conjunction with the Corporate Governance Committee to recommend revisions to the Governance Guidelines;
- Call, coordinate, develop the agenda for and chair executive sessions of the Board's independent directors; act as principal liaison between the independent directors and the CEO;

  Work in conjunction with the Corporate Governance and Nominating Committee to identify for appointment the members of the various Board Committees, as well as selection of the Committee chairs;
- Be available for consultation and direct communication with major shareholders;
- Make commitment to serve in role of Lead Director for a minimum of three years; and
- Help set the tone for the highest standards of ethics and integrity.

  Adopted by the Board to be effective as of January 1, 2018

SUMMARY

This unit has provided a summary in which has been conducted in the field of agency theory and corporate governance designed to minimize its damage to shareholder wealth. In general, the only strong conclusion which appears to have been suggested is that what is optimal for one firm at one point in time, need not be so for another. In efficient markets it could be argued that firms and investors will choose between these various devices based upon their optimal contracting relationships. While, at the same time, large divergences of interest by management always carries the threat of external market discipline from labor markets and the market for corporate control

QUESTIONS

Conceptual Type

1. Meaning and Definition of Agent & Institution
2. Who is Agent?
3. What is Institution?
4. Who is Stock holder?
5. Who is Auditor?

Analytical Type

1. Describe what is the Relationship between Agent &Institution ?
2. What is Rights of Shareholder under Companies Act2013?
3. What are the Rights privileges of Stock holders? Discuss
4. What is the Role and Responsibilities of Director, Auditor & bank in CG?
5. Discuss about the Board Committee &its Performance?

UNIT 4 INDIAN SCENARIO, PUBLIC POLICIES SEBI, CORPORATION IN GLOBAL SOCIETY

Structure

4.1 Present Framework of Corporate Governance in Indian
4.2 Various Policies to be Framed as per SEBI Regulations, 2015
4.3 Securities and Exchange Board of India (SEBI)
4.4 Corporate Social Responsibility (CSR)
4.5 Corporate Governance - in Global Society and the Environment
Summary
Questions

LESSON OUTLINE

- Introduction & definition an Indian scenario
- Present frame work of CG in India
- SEBI Policy & Regulation 2015
- Corporate and social Responsibility
- CG in Global society & the environment

LEARNING OBJECTIVES

After going through this unit, you will be able to:

- Meaning and Definition of an Indian scenario
- What is the frame work of CG In India
- What is SEBI policy & what is the Regulation 2015
- What are social Responsibility

INTRODUCTION

Corporate governance has become a very hot issue these days because good governance has become a casualty at all levels. Corporate governance is concerned with set of principles, ethics, values, morals, rules regulations & procedures. Corporate governance establishes a system whereby directors are entrusted with duties and responsibilities in relation to the direction of the company's affairs. Corporate governance includes Honesty, Disclosure, Transparency, Sustainability and Responsibility. The UNDP Human Development report labelled the economic growth as ruthless, rootless and jobless. It highlighted that economic development is the means (way to achieve the goal) and human development should be the goal. Even today, for many companies Corporate Governance has only a shareholder focus. The reference point usually is the company's law and the relevant guidelines of Securities Exchange Board of India (SEBI). For Human resource professionals and human resource function (HR), however, the concept of CG is much wider. HR has a key role to shift focus to multi-stakeholder focus with a 'balanced score card' perspective. HR perspective on Corporate Governance should focus on, among others, the following:

1. Respect for universal human rights and freedoms
2. Internalize international labour standards
3. Practice codified ethics and codes of conduct
4. Develop/benchmark best practices and follow them
5. Conduct internal and external (including social) audit of HR policies Corporate Governance increases the accountability of the individuals and is aimed at reducing the principal agency problem. As per Cadbury Committee "Corporate Governance is a system by which companies are

directed and controlled to ensure future growth and survival of the business". In short, Corporate Governance is aimed at increasing the value for shareholders and can act as a competitive advantage because it is aimed towards the long term sustainability of the business. The philosophy of governance and ethics is not new as a concept. In fact in the Indian tradition, this has been a deep rooted and fundamental basis of all religious and scriptural teachings. Sadly, businesses today seek exponential growth and the profits have overlooked the means to generating returns to shareholders and stakeholders. Profits however are not a bad word. But, when the companies use the unethical means to achieve the same, then businesses runthe risk of permanently damaging their reputation and goodwill. The Organization for Economic Cooperation and Development (OECD), which, in 1999, published its Principles of Corporate Governance gives a very comprehensive definition of corporate governance, as under: "a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and shareholders, and should facilitate effective monitoring; thereby encouraging firms to use recourses more efficiently."

So, authors have mainly focused on the growth of Shareholders which could eventually improve the corporate governance of the firm in India. Carter et al. (2010) studied that good corporate governance can be promoted and improved by more gender diverse boards on board room which will ultimately grow the firm's financial performance. Andrew Kakabadse (2010) emphasized more on six dimensions i.e. political, Civil, Judicial, Administrative, economic and financial spheres of the firm that are to be focused under corporate governance body as these dimensions are the benchmark for every business and on there basis the corporate governance position are varied. Prof. Rana Singh (2014) studied the changing dimensions of corporate governance in India and explained the role of Good Governance in Indian firms and concluded that more tighter the rules of corporate governance, better will the working of firms. As, it is very important to safeguard stakeholders and shareholders of the company from fraudulence and scandals which are only possible with the help of disciplined corporate governance body. Raja Mariappan et al. (2014) stipulated that for enhancement of firm's performance it is uttermost important to have good governance factor. As success and growth of any firm is mainly dependent upon the effective and good corporate governance. The authors found that there is no significant relationship between corporate governance practices and firm's performance as there is no impact of corporate governance on firm's performance. Further analyzing the results that three variable – Firm size, Insider ownership and Board independence were insignificant which leads the investors to carefully invest and take decision accordingly. Overall study revealed two aspects, firstly, good corporate governance regime is needed to improve the decision making qualities of board of directors and secondly, good corporate governance will lead to increase in shareholders returns. Smita Jain (2015) explained the importance of corporate governance in present scenario in India and laid immense importance on various committees form to regulate corporate governance regulations like Kumar Manglam Birla Committee, Cadbury

Committee Report, OECD Principles, SarbanesOxley Act, Narayana Murthy Committee, ICSI, SEBI etc and concluded the performance of Indian firms after Companies Act, 2013 have improved 30% specifically breaking the Glass –Ceiling effect in Indian firms resulting in betterment of Corporate governance and increasing the role of Women directors on Boardroom.

4.1 PRESENT FRAMEWORK OF CORPORATE GOVERNANCE IN INDIAN

The key question is that despite all this why have the incidences of non compliance, evasion and wrong reporting not subsided in the world of Business? Does it imply that India need stricter regulations and control or is it that Businesses are by nature willing to do the wrong things, even at the cost of a permanent damage to their reputation and image? Given the series of corporate scandals that hit the world headlines from Enron and WorldCom in the early part of2000 to the Wall Street fiasco that led to a global financial meltdown through the sub-prime crisis recently in the US, to the Satyam scam

closer home, we witness one common thread of dissonance. Simply put, this is a lack of 'Conscious Commitment' in letter and spirit to the core values of honesty, integrity and transparency by the senior leadership team of large enterprise Series of corruption scandals in India have embarrassed the ruling of corporate governance, rattled markets and delayed reform bills as the opposition stalls parliament. The country, 87th in Transparency International's rankings based on perceived levels of corruption, is no stranger to scandals. In the Indian context Satyam scandal and various other scandals has brought to focus the role of independent directors in the companies. This may not be an India-specific story. In fact, history of capitalism regularly produces headline-making such scandals. Enron for example, the energy company has become a byword for company fraud. It had 22,000 employees and claimed revenue of nearly $100bn the year before its 2001 collapse. The group had a complex accounts structure, under which huge debts were hidden behind fraudulent off-balance sheet partnerships. Its top executives were found guilty of insider trading and lying to investors. Heeding this fundamental wisdom, various regulatory agencies thought it appropriate to advise the companies to incorporate independent members on their Board. This may have two broad objectives: one, effective corporate governance, and two, investors' confidence. In fact, Corporate Governance in the UK and the Code of Corporate Governance Practices, emphasize the role and responsibilities of the non-executive directors, including the need for an independent board and independent non-executive directors. Independent non-executive directors are expected not only to participate in committees such as the audit, remuneration and nomination committees but also to form the Majority in such committees. Build lasting goodwill and reputation for their organizations. Socially responsible actions that are not merely rhetoric but are sincere and honest is the only route to restoring the goodwill of public and other stakeholders towards business entities. Hopefully, the lessons learnt from the many mistakes of the past will rejuvenate corporations to realign and entrust the reins of leadership to people who command respect through their conduct and professional expertise. They in turn can then demonstrate qualities that inspire their teams to set the highest standards of personal and professional integrity for managing the many challenges that lie ahead of enterprises in the future.

4.2 VARIOUS POLICIES TO BE FRAMED AS PER SEBI REGULATIONS, 2015

Introduction

Securities and Exchange Board of India (SEBI) on 2nd September, 2015 issued the **SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015** (**'Listing Regulations'**) with the aim of bringing the basic framework governing the regime of listed entities in line with the Companies Act, 2013 and compiling all the mandates of SEBI regulations/ circulars governing equity as well as debt segments of capital market under the ambit of single document.

The Listing Regulations are effective from 90 days from the date of notification of these regulations i.e. 1st December, 2015.

As per the Listing Regulations, all listed entities are required to frame various policies which are detailed below:

B. Gist of policies to be adopted

I. Policy for preservation of documents
II. Policy for determining material subsidiary
III. Policy on materiality of related party transactions
IV. Policy for determination of materiality
V. Archival Policy
VI. Vigil Mechanism/ Whistle Blower policy
VII. Policy relating to remuneration of the directors, key managerial personnel and other employees
VIII. Policy on diversity of board of directors

C. Detailed notes on above policies

I. Policy for preservation of documents [Regulation 9)]

Objective: To classify the documents, records and registers of the Listed Company at least under two categories:

a. to be preserved permanently

b. to be preserved for period of not less than 8 (eight) years.

The listed entity may preserve the above said documents in electronic mode.

II. Policy for determining material subsidiary [Regulation 16(1)(c]

Objective: To determine the material subsidiaries of a Listed Company and to provide the governance framework for such subsidiaries.

"material subsidiary" shall mean a subsidiary, whose income or net worth exceeds 20% of the consolidated income or net worth respectively, of the listed entity and its subsidiaries in the immediately preceding accounting year.

III. Policy on materiality of related party transactions and on dealing with related party transactions [Regulation 23]

Objective: To ensure proper approval of related party transactions.

A transaction with a related party shall be considered material if the transaction(s) to be entered into individually or taken together with previous transactions during a financial year, exceeds 10% of the annual consolidated turnover of the listed entity as per the last audited financial statements of the listed entity.

All related party transactions have to be previously approved by the audit committee and require approval of the shareholders.

IV. Policy for determination of materiality [Regulation 30(4)(ii)]

Objective: To protect the confidentiality of material/price sensitive information of a Listed Company

Every listed entity has to make disclosures of any events or information which, in the opinion of the board of directors of the listed company, is material.

Criteria for determination of materiality of events/ information:

a. the omission of an event or information, which is likely to result in discontinuity or alteration of event or information already available publicly; or

b. the omission of an event or information is likely to result in significant market reaction if the said omission came to light at a later date;

c. If, the above two clauses are not applicable, an event/information may be treated as being material if in the opinion of the board of directors of listed entity, the event / information is considered material.

V. Archival Policy [Regulation 30(8)]

Objective: To ensure that all the information which, has been disclosed to stock exchange(s) under this regulation and such information which in the opinion of the board of directors of a listed company, is material has to be made available on the Company's website for public/members.

The material information of a listed company shall be hosted on its website for a minimum period of 5 (five) years and thereafter will be archived for a further period as specified in its Archival Policy.

VI. Vigil Mechanism/ Whistle Blower Policy [Regulation 22

Objective: The Vigil Mechanism/Whistle Blower Policy is implemented to safeguard the unethical practices and to provide mechanism for reporting genuine concerns or grievances.

Every listed entity has to formulate a vigil mechanism for directors and employees to report genuine concerns.

The vigil mechanism has to provide for adequate safeguards against victimization of director(s) or employee(s) or any other person who avail the mechanism and also provide for direct access to the chairperson of the audit committee in appropriate or exceptional cases.

VII. Policy relating to remuneration of the directors, key managerial personnel and other employees [Schedule II & PART D]

The Nomination and Remuneration Committee of every listed company has to recommend to its board of directors, a policy relating to remuneration of the directors, key managerial personnel and other employees.

Nomination and Remuneration Committee

Every listed company has to set up a Nomination and Remuneration committee comprising at least three directors, all of whom shall be non-executive directors and at least half shall be independent. Chairman of the committee shall be an independent director.

Role of Nomination and Remuneration Committee:

1. formulation of the criteria for determining qualifications, positive attributes and independence of a director and recommend to the board of directors a policy relating to, the remuneration of the directors, key managerial personnel and other employees;
2. formulation of criteria for evaluation of performance of independent directors and the board of directors;
3. devising a policy on diversity of board of directors;
4. identifying persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, and recommend to the board of directors their appointment and removal.
5. whether to extend or continue the term of appointment of the independent director, on the basis of the report of performance evaluation of independent directors.

VIII. Policy on diversity of board of directors

Objective: To enhance the effectiveness of the Board by diversifying its composition and to obtain the benefit out of such diversity in better and improved decision making.

In order to ensure that the Company's boardroom has appropriate balance of skills, experience and diversity of perspectives that are imperative for the execution of its business strategy, the Company shall consider a number of factors, including but not limited to skills, industry experience, background, race and gender.

4.3 SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI)

BSE has vide its Circulars dated November 30, 2015, March 11, 2016, March 16, 2016 and January 18, 2017 intimated the listed companies regarding mandatory filing of information with the exchange in electronic mode. BSE has now with a view to make the disclosure more accurate and efficient mandated the filing of the following regulations in XBRL:-

1. Corporate Governance (Regulation 27)
2. Shareholding Pattern (Regulation 31)
3. Voting Results (Regulation 44)

It has also been decided that with effect from April 01, 2017 onwards, all listed entities with BSE, would be required to make their filings in respect of financial results (Regulation 33 and Regulation 52) in XBRL mode within 24 hours of submission of results in PDF mode. This requirement however, would not apply to insurance companies which can continue to make their filings for financial results in PDF mode only.

Financial Results are required to be submitted along with the Limited Review Report / Audit Report first, in PDF mode through the Listing Centre website – Corporate Announcement Filing System (CAFS) within 30 minutes of the conclusion of the Board Meeting.

This is required to be followed by filing of the result in XBRL mode within 24 hours from the conclusion of the Board Meeting.

It has been clarified that filing of Financial Results (Regulation 33 and Regulation 52) in other mode would be treated as non-submission and may attract penalties as prescribed by SEBI in the SOP circular dated November 30, 2016.

Listing of Non - Convertible Redeemable Preference Shares (NCRPS) / Non - Convertible Debentures (NCDs) through a Scheme of Arrangement

1. SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 places obligations with respect to Scheme of Arrangement on Listed Entities and Stock Exchange(s).
2. Sub - rule (7) of rule 19 of the Securities Contracts (Regulation) Rules, 1957 gives power to Securities and Exchange Board of India (SEBI) to relax provisions and lay down the detailed requirement to be complied with by listed entities while undertaking schemes of arrangement for listing of Equity or Warrants pursuant to the Scheme.
3. In cases where NCRPS/NCDs are issued, in lieu of specified securities, vide a scheme of arrangement; and where such NCRPS/NCDs are proposed to be listed on recognised Stock Exchanges, the listed entity shall comply with the some additional requirements.

However additional conditions have to be complied before the Scheme of arrangement is submitted for sanction by the National Company Law Tribunal (NCLT) as per the said circular.

4.4 CORPORATE SOCIAL RESPONSIBILITY (CSR)

Corporate Social Responsibility (CSR) is organisation's performance against economic, social and environmental parameters. The theory behind CSR is that companies can be profitable while at the same time minimize their negative impact on the stakeholders. Many studies were conducted to understand whether ethics pay and found a positive correlation between better financial performance and better social performance. In recent years CSR has become an independent business practice and has gained much attention of chief executives, board of directors and executive management teams of larger companies. They understand that a strong CSR program is an essential element in achieving good business practice and effective leadership. Companies have understood that their impact on the economic, social and environmental landscape directly affects their relationship with stakeholders, investors, employees, customers, business partners, government and communities. Requirement for CSR Audit and reporting: Social responsibility is a major concern for management from a reputation risk perspective. Typically, reputation risk is associated with fraudulent reporting, regulatory actions against a company, or misconduct of individual officers (for example, personal tax fraud). However the scope of social responsibility has been expanding continuously to include several aspects that are perceived by the public to be the social impact of business actions. Such initiatives are also subject to internal controls and should be considered for periodic review of their accounting and oversight processes. The audit interlaid would encompass whether the target corporate has formulated CSR policy which adequately addresses the CSR concerns, whether adequate resources were provided, whether proper internal control systems were adopted, whether safety measures required if any were taken, whether the corporate has been able to fulfill their social responsibility in an effective and efficient manner. Recognition of CSR reporting in global: In the post-Enron era, the number of companies reporting their social and environmental impact on society has increased immeasurably. CSR reporting is akin to reporting financials, but rather than focusing on the numbers (i.e. profits), there is an emphasis on the people and planet impacts. From the information gathered by the writer, presently environmental reporting is mandatory for public corporations in Sweden, Norway, Netherlands, Denmark, France and Australia. Although Japan and the U.K. do not have mandatory CSR disclosures, most companies in these countries choose to participate. Despite the lack of regulations in the United States requiring companies to disclose, increasingly more and more companies are issuing CSR reports for a variety of reasons. Research suggest that there are three main theories for this increasing trend

a. to manage the perceptions of key stakeholders;
b. to convey the organization's values to the public,
c. to establish that the organization's activities are in line with social norms.

CSR activities and reporting requirement in India: Corporate Social Responsibility is not a new concept in India. Corporates like the Tata, the Aditya Birla, Indian Oil Corporation and Reliance to name a few, have been involved in serving the community to the extent possible since long time. Many more organisations have been doing their part services through donations and charity events. Some of the big corporates in India have set up CSR policy, their vision and mission beside giving sufficient support to ensure to adhere to the policies, creating internal controls, audit and reporting. The parliamentary

panel has recommended having a clause in the Companies Bill, 2011 that makes it mandatory for companies to contribute to corporate social responsibility initiatives and report on their performance including giving an explanation if they cannot perform

4.5 CORPORATE GOVERNANCE — IN GLOBAL SOCIETY AND THE ENVIRONMENT

Our societies are all scarred by Milton Friedman's creed that "the social responsibility of business is to increase its profits"; our economies are all wounded by corporations' obsessive pursuit for short-term profit maximization; regrettably, we all pay the price of dodgy and excessive corporate risk taking at the expense of long-term reasonable wealth creation and distribution.

> *"After the financial crisis, there has been considerable debate about the role of corporations in society. It has become broadly accepted that corporations – particularly the world's largest publicly traded corporations – need to be governed with respect for the society and the environment. This is because corporations are dependent on the broader institutional and systemic framing for their long-term survival and because the most pressing of society's problems cannot be solved without a contribution from corporations or by regulation alone. However, this consensus has not yet been reflected in mainstream corporate governance models that have been narrowing since the 1970s in order to put the maximisation of shareholder value at the centre of corporate attention."*

Compared to just a decade ago, it is now common for businesspeople to talk about social responsibility and the importance of being good corporate citizens. Many business leaders today consider it critical to engage with shareholders, the communities in which their companies operate, and others affected by and interested in what they do. The diverse activities needed to respond to these expanded duties are widely referred to by the catchall phrase "corporate social responsibility." It incorporates a host of concepts and practices, including the necessity for adequate corporate governance structures, the implementation of workplace safety standards, the adoption of environmentally sustainable procedures, and philanthropy.

Blanketing these various responsibilities with the single term "corporate social responsibility" is an oversimplification that has led to a great deal of confusion. It is necessary to distinguish between the different types of corporate activities, so that the work companies do to engage in society is fairly recognized and appreciated and companies are better able to benchmark themselves against the performance of different enterprises and learn from example. A better understanding of engagement requires separate definitions for corporate governance, corporate philanthropy, and corporate social responsibility as well as for an emerging element: corporate social entrepreneurship, that is, the transformation of socially responsible principles and ideas into commercial value.

Above all, a new imperative for business, best described as "global society must be recognized. It expresses the conviction that companies not only must be engaged with their stakeholders but are themselves stakeholders alongside governments and civil society.

SUMMARY

In this units organizational framework for corporate governance initiatives in India consists of the Ministry of Corporate Affairs (MCA) and the Securities and Exchange Board of India (SEBI). SEBI monitors and regulates corporate governance of listed companies in India through Clause 49. This clause is incorporated in the listing agreement of stock exchanges with companies and it is compulsory for listed companies to comply with its provisions. MCA through its various appointed committees and forums such as National Foundation for Corporate Governance (NFCG), a not-for-profit trust, facilitates exchange of experiences and ideas amongst corporate leaders, policy makers, regulators, law enforcing agencies and non- government organizations.it is important to have rules in place for all companies to ensure a truly level playing field, and to avoid competition issues of forum shopping for stock exchanges. Market regulators and operators should engage and work with governments in this regard.

QUESTIONS

Conceptual Type

1. What is Indian scenario of CG?
2. What is SEBI?
3. What is corporate social Responsibility?
4. What is Globe Society?

Analytical Type

1. What is Indian scenario of CG? Discuss
2. What are the various policies framed as per SEBI Regulation, 2015? Discuss
3. What is corporate Social Responsibility?
4. How to help the Corporate Governance in Global Society?

UNIT 5 SOCIAL RESPONSIBILITY: CS IN INDIA, USA AND OTHER COUNTRIES, CSR LAWS IN INDIA

Structure

5.1 What is CSR?
5.2 For Whom it's Applicable?
5.3 What to do when CSR is Applicable?
5.4 The Objectives of the Policy
5.5 The Concept of CSR in India
5.6 The Key Components of CSR would therefore Include the Following
5.7 Corporate Social Responsibility
 5.7.1 Corporate Social Responsibility (CSR) in Different Countries
 5.7.2 Other Countries
5.8 Corporate Social Responsibility under Companies Act
Summary
Answers

LESSON OUTLINE

- Introduction
- Corporate social responsibility.
- What is CSR?
- For whom it's Applicable.
- What to do when CSR is Applicable.
- The objectives of the policy.
- Definition of CSR.
- Key components of CSR in India
- Social Responsibility - Introduction of India, USA & bother countries.
- Responsibility in different countries
- Social Responsibility under company ACT.

LEARNING OBJECTIVES

After going through this unit, you will be able to:

- Meaning and Definition of Social Responsibility
- What is CSR? Meaning and Definition
- Social Responsibility of USA& bother countries
- What are the Responsibility under company ACT

INTRODUCTION

As the term "CSR" is used continually, many complementary and overlapping concepts, such as corporate citizenship, business ethics, stakeholder management and sustainability, have emerged. These extensive ranges of synonymously used terms indicate that multiple definition have been devices for CSR mostly from different perspectives and by those in facilitating roles such as the corporate sector, government agencies, academics and the public sector. A widely cited definition of CSRin the business and social context has been given by the European Union (EU). It describes CSR as "the concept that an enterprise is accountable for its impact on all relevant stakeholders. It is the continuing commitment by business to behave fairly and responsibly, and contribute to economic development while improving the quality of life of the work force and their families as well as of the local community and society at large…1" In other

words, CSR refers to ensuring the success of the business by inclusion of social and environmental considerations into a company's operations. It means satisfying your shareholders' and customers' demands while also managing the expectation of other stakeholders such as employees, suppliers and the community at large. It also means contributing positively to society and managing your organization's environmental impact.2 Hence, CSR is a contribution to

Sustainable development, implying the way a company balances its economic, environmental and social objectives while addressing stakeholder expectations and enhancing shareholder value. CSR not only includes the activities that a company undertakes in order to utilize their profit to enable social and environmental development, but also includes the methods that a company employs these profit including responsible investments, and transparency to various stakeholders among others. Realizing the importance and the long term benefits of being socially responsible many company have incorporated socially responsible business practices. The basic objective of CSR is to maximize the company's overall impact on the society and stakeholders while considering environment and overall sustainability.

5.1 WHAT IS CSR?

The term "Corporate Social Responsibility (CSR)" can be referred as corporate initiative to assess and take responsibility for the company's effects on the environment and impact on social welfare. The term generally applies to companies efforts that go beyond what may be required by regulators or environmental protection groups. Corporate social responsibility may also be referred to as "corporate citizenship" and can involve incurring short-term costs that do not provide an immediate financial benefit to the company, but instead promote positive social and environmental change. Moreover, while proposing the Corporate Social Responsibility Rules under Section 135 of the Companies Act, 2013, the Chairman of the CSR Committee mentioned the Guiding Principle as follows: "CSR is the process by which an organization thinks about and evolves its relationships with stakeholders for the common good, and demonstrates its commitment in this regard by adoption of appropriate business processes and strategies. Thus CSR is not charity or mere donations. CSR is a way of conducting business, by which corporate entities visibly contribute to the social good. Socially responsible companies do not limit themselves to using resources to engage in activities that increase only their profits. They use CSR to integrate economic, environmental and social objectives with the company's operations and growth3 ."

5.2 FOR WHOM IT'S APPLICABLE?

The companies on whom the provisions of the CSR shall be applicable are contained in Sub Section 1 of Section 135 of the Companies Act, 2013. As per the said section, the companies having Net worth of INR 500 crore or more; or Turnover of INR 1000 crore or more; or Net Profit of INR 5 crore or more during any financial year shall be required to constitute a Corporate Social Responsibility Committee of the Board "hereinafter CSR Committee" with effect from 1st April, 2014. The pictorial representation below gives the representation of Section 135 (1).

The above provision requires every company having such prescribed Net worth or Turnover or Net Profit shall be covered within the ambit of CSR provisions. The section has used the word "companies" which connotes a wider meaning and shall include the foreign companies having branch or project offices in India.

5.3 WHAT TO DO WHEN CSR IS APPLICABLE?

Once a company is covered under the ambit of the CSR, it shall be required to comply with the provisions of the CSR. The companies covered under the Sub section 1 of Section 135 shall be required to do the following activities:

1. As provided under Section 135(1) itself, the companies shall be required to Constitute Corporate Social Responsibility Committee of the Board "hereinafter CSR Committee". The CSR Committee shall be comprised of 3 or more directors, out of which at least one director shall be an independent director.
2. The Board's report shall disclose the compositions of the CSR Committee.

3. All such companies shall spend, in every financial year, at least two per cent of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy. It has been clarified that the average net profits shall be calculated in accordance with the provisions of Section 198 of the Companies Act, 2013. Also, proviso to the Rule provide 3(1) of the CSR Rules that the net worth, turnover or net profit of a foreign company of the Act shall be computed in accordance with balance sheet and profit and loss account of such company prepared in accordance with the provisions of clause (a) of sub-section (1) of section 381 and section 198 of the Companies Act, 2013

5.4 THE OBJECTIVES OF THE POLICY

1. This Policy shall be read in line with Section 135 of the Companies Act 2013, Companies (Corporate Social Responsibility Policy) Rules, 2014 and such other rules, regulations, circulars, and notifications (collectively referred hereinafter as Regulations‘) as may be applicable and as amended from time to time and will, inter-alia, provide for the following:
   - Establishing a guideline for compliance with the provisions of Regulations to dedicate a percentage of Company‘s profits for social projects.
   - Ensuring the implementation of CSR initiatives in letter and spirit through appropriate procedures and reporting
   - Creating opportunities for employees to participate in socially responsible initiatives.

   Definitions

   In this Policy unless the context otherwise requires:

   (a) “Act” means the Companies Act, 2013;

   (b) “Annexure” means the Annexure appended to these rules;

   (c) “Corporate Social Responsibility (CSR)” means and includes but is not limited to

      (i) Projects or programs relating to activities specified in Schedule VII to the Act or

      (ii) Projects or programs relating to activities undertaken by the board of directors of a company (Board) in pursuance of recommendations of the CSR Committee of the Board as Per declared CSR Policy of the company subject to the condition that such policy will cover subjects enumerated in Schedule Vll of the Act.

   (d) “CSR Committee” means the Corporate Social Responsibility Committee of the Board referred to in section 135 of the Act

   (e) “CSR Policy” relates to the activities to be undertaken by the company as specified in Schedule VII to the Act and the expenditure thereon, excluding activities undertaken in pursuance of normal course of business of a company.

   (f) “Net profit” means the net profit of a company as per its financial statement prepared in accordance with the applicable provisions of the Act, but shall not include the following, namely :-

      (i) Any profit arising from any overseas branch or branches of the company’ whether operated as a separate company or otherwise;

      (ii) Any dividend received from other companies in India, which are covered under and complying with the provisions of section 135 of the Act: Provided that net profit in respect of a financial year for which the relevant financial

2. Words and expressions used and not defined in these rules but defined in the Act shall have the same meanings respectively assigned to them in the Act.

5.5 THE CONCEPT OF CSR IN INDIA

The emerging concept of Corporate Social Responsibility (CSR) goes beyond charity and requires the company to act beyond its legal obligations and to integrated social, environmental and ethical concerns into company’s business process.

Business has today, emerged as one of the most powerful institutions on the earth. Some of the biggest companies in the world are in fact, bigger in size than some of the developing countries of the world. Globalization makes the world smaller, and business, worldwide, is expanding like never before. Companies are expanding their operations and crossing geographical boundaries.

Indian companies too have made their way into the business boom and are today globally acknowledged as major players. India is currently amongst the fastest growing countries in the world. The globalization and liberalization of the Indian economy has helped in stepping up growth rates. Integration of the Indian with the global economy has also resulted in Indian businesses opening up to international competition and thereby increasing their operations.

In the current scheme of things, business enterprises are no longer expected to play their traditional role of mere profit making enterprises. The ever-increasing role of civil society has started to put pressure on companies to act in an economically, socially and environmentally sustainable way.

The companies are facing increased pressure for transparency and accountability, being placed on them by their employees, customers, shareholders, media and civil society.

Business does not operate in isolation and there is today, an increased realization that not only can companies affect society at large, but they are also in a unique position to influence society and make positive impact.

Milton Friedman, Nobel Laureate in Economics and author of several books wrote in 1970 in the New York Times Magazine that “the social responsibility of business is to increase its profits” and “the business of business is business”. This represented an extreme view that the only social responsibility a law-abiding business has is to maximize profits for the shareholders, which were considered the only stakeholders for the company. However, time has given the term ‘stakeholder’ wider connotations.

Edward Freeman defines, ‘a stakeholder in an organization is any group or individual who can affect or is affected by the achievement of the organization’s objectives.’ Thus, the term stakeholder includes (apart from shareholders), but not limited to, customers, employees, suppliers, community, environment and society at large.

These and a host of other such ideas have given rise to the concept of Corporate Social Responsibility (CSR). The concept of CSR goes beyond charity or philanthropy and requires the company to act beyond its legal obligations and to integrate social, environmental and ethical concerns into its business process. Business for Social Responsibility defines CSR as “achieving commercial success in ways that honor ethical values and respect people, communities, and the environment.

It means addressing the legal, ethical, commercial and other expectations that society has for business and making decisions that fairly balance the claims of all key stakeholders. In its simplest terms it is: “what you do, how you do it, and when and what you say.” A widely quoted definition by the World Business Council for Sustainable Development states that ”Corporate social responsibility is the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large”.

Though, there is no universal definition of CSR but the common understanding amongst most of these definitions concern with how the profits are made and how they are used, keeping in mind the interests of all stakeholders. The concept of Corporate Social Responsibility is constantly evolving.

The emerging concept of CSR goes beyond charity and requires the company to act beyond its legal obligations and to integrate social, environmental and ethical concerns into company’s business process. What is generally understood by CSR is that the business has a responsibility – towards its stakeholders and society at large – that extends beyond its legal and enforceable obligations.

The triple bottom line approach to CSR emphasizes a company’s commitment to operating in an economically, socially and environmentally sustainable manner. The emerging concept of CSR advocates moving away from a ‘shareholder alone’ focus to a ‘multi-stakeholder’ focus. This would include investors, employees, business partners, customers, regulators, supply chain, local communities, the environment and society at large.

5.6 THE KEY COMPONENTS OF CSR WOULD THEREFORE INCLUDE THE FOLLOWING

Corporate

Governance: Within the ambit of corporate governance, major issues are the accountability, transparency and conduct in conformity with the laws. Good corporate governance policy would enable the company to realize its corporate objectives, protect shareholder rights, meet legal requirements and create transparency for all stakeholders.

Business Ethics: Relates to value-based and ethical business practices. 'Business ethics defines how a company integrates core values – such as honesty, trust, respect, and fairness – into its policies, practices, and decision making. Business ethics also involves a company's compliance with legal standards and adherence to internal rules and regulations.'1

Workplace and labour relations: Human resources are most important and critical to a company. Good CSR practices relating to workplace and labour relations can help in improving the workplace in terms of health and safety, employee relations as well as result in a healthy balance between work and non-work aspects of employees' life. It can also make it easier to recruit employees and make them stay longer, thereby reducing the costs and disruption of recruitment and retraining.

Affirmative action/good practices: Equal opportunity employer, diversity of workforce that includes people with disability, people from the local community etc., gender policy, code of conduct/guidelines on prevention of sexual harassment at workplace, prevention of HIV/AIDS at workplace, employee volunteering etc. are some of the good practices which reflect CSR practices of the company.

Supply Chain: The business process of the company is not just limited to the operations internal to the company but to the entire supply chain involved in goods and services. If anyone from the supply chain neglects social, environmental, human rights or other aspects, it may reflect badly on the company and may ultimately affect business heavily. Thus, company should use its strategic position to influence the entire supply chain to positively impact the stakeholders.

Customers: The products and services of a company are ultimately aimed at the customers. The cost and quality of products may be of greatest concern to the customers but these are not the only aspects that the customers are concerned with. With increased awareness and means of communication, customer satisfaction and loyalty would depend on how the company has produced the goods and services, considering the social, environmental, supply-chain and other such aspects.

Environment: Merely meeting legal requirements in itself does not comprise CSR but it requires company to engage in such a way that goes beyond mandatory requirements and delivers environmental benefits. It would include, but not limited to, finding sustainable solutions for natural resources, reducing adverse impacts on environment, reducing environment-risky pollutants/emissions as well as producing environment-friendly goods.

Community: A major stakeholder to the business is the community in which the company operates. The involvement of a company with the community would depend upon its direct interaction with the community and assessment of issues/risks faced by those living in the company surrounding areas. This helps in delivering a community-focused CSR strategy – making positive changes to the lives of the people and improving the brand-image of the company. Involvement with the community could be both direct & indirect – through funding and other support for community projects implemented by local agencies.

5.7 CORPORATE SOCIAL RESPONSIBILITY

Introduction of India, USA and other Major Countries

CSR is increasingly integrated as a business strategy and has maintained a proper place in the policies and practices around the globe. A number of factors are supplementing the awareness about CSR in a corporate setting. At an international level, a number of multi-stakeholder firms, non-profit organizations as well as inter-governmental organizations are taking initiatives to adopt CSR as an integral part of

their business processing's. The organizations are adopting CSR as a part of their policy matters to increase the demands and interest of different stakeholders and to enhance the competition to access the global market and satisfying the needs of society. Corporate social responsibility (CSR) in different countries

In major markets of the world, the corporate social responsibility is not a new term. In the last decade, the social media has come up with a number of ideas and opportunities for the companies to get creative with the initiative of CSR and examine this new kind of engagement. On the whole, the CSR industry continued to gain a grip with an impressive social impact, making its way to transparency.

At the same time, the rich data and communication technologies have helped the companies to deal with environmental and social issues. The experts believe that smart devices with rich data sources are better in exchanging knowledge and these advanced technologies have helped to solve bigger issues, around the globe.

The corporate social responsibility has become complete decree.

The Committee Encouraging Corporate Philanthropy has seen a prominent trend, around the globe, that certain regions of the world have obliged certain aspects of the corporate social engagement. The corporate entities that have current or about to grow multi-national footprint are in need of understanding this emerging landscape while addressing their social investment programs and the support compliance. In some emerging markets like Indonesia and Brazil, there are regulations that determine a particular type or level of corporate social investments.

In most parts of the world, the minorities are another most focused part of the society, when it comes to the appreciation of the CSR. There are a number of recorded initiatives, focused on the empowerment of girls and women rights. At the same time, the social impact has made its way to recommence and become a mission card. Professional on social network seemed to be more willing to volunteer their skills to induce a positive impact on the society and their circle.

To the fact, CSR has a huge impact on the climatic changed and the global environment on the whole. At the time when the global industries like textile are working keenly on the idea of sustainability in their production, the results are remarkable and come up with a massive positive impact on the society and the global climate on the whole. There are a number of big trends that are on the go, focusing on the climatic measurement and changes.

5.7.1 Corporate Social Responsibility (CSR) in Different Countries

The concept of Corporate Social Responsibility say that it is positive step in the sense that it helps the company make long term profits while doing some social good as well. This statement is rebutted by saying that too much work would just distract the company from achieving its main aim of profit making. Studies have proved that when a model for corporate social responsibility is properly executed, it has a neutral effect on the financial outcome.

The **United Nations Industrial Development Organization** defines corporate social responsibility as "a management concept whereby companies integrate social and environmental concerns in their business operations and interactions with their stakeholders."

The world has become more and more aware. All the major players have been contributing to the society in one way or another. If we take the example of India, Aptech, a leading education player with a global presence that has played a broad and continued role in encouraging and nurturing education throughout the country since its inception. As a global player with complete solutions-providing capabilities, Aptech has a long history of participating in community activities. It has, in association with leading NGOs, provided computers at schools, education to the deprived, and training and awareness-camps.

This concept of Corporate Social Responsibility has been introduced all across the globe. Different countries have different ways of application. What is common is that all the countries use the LBG model to assess the real value and impact of their community investment to both, the business and society.

When we talk about Corporate Social Responsibility (CSR), it is understood that it is executed after a lot of planning and strategising.

Here is a brief comparison of the CSR regulation across the globe!

(1) In USA

The Corporate Social Responsibility (CSR) team in the Bureau of Economic and Business Affairs leads the Department's engagement with U.S. businesses in the promotion of responsible and ethical business practices. The mission of the CSR office is to:

- Promote a holistic approach to CSR to complement the EB Bureau's mission of building economic security and fostering sustainable development at home and abroad.
- Provide guidance and support for American companies engaging in socially responsible, forward-thinking corporate activities that complement U.S. foreign policy and the principles of the Secretary's Award for Corporate Excellence program.
- Build on this synergy, working with multinational companies, civil society, labour groups, environmental advocates, and others to encourage the adoption of corporate policies that help companies "do well by doing good."

(2) In UK

It is a part of Corporate Governance. The Companies Act 2006 has now added to those pressures by requiring directors to have regard to community and environmental issues when considering their duty to promote the success of their company and by the disclosures to be included in the Business Review. CSR is, now, an integral part of good governance, for bigger companies in particular.

(3) In Europe

The European Commission's CSR agenda for action is:

- Enhancing the visibility of CSR and disseminating good practices.
- Improving and tracking levels of trust in business.
- Improving self and co-regulation processes.
- Enhancing market reward for CSR
- Improving company disclosure of social and environment information.
- Further integrating CSR into education, training and research.
- Emphasising the importance of national and sub-national CSR policies.
- Better aligning European and global approaches to CSR.

The CSR strategy is built upon guidelines and principles laid down by the United Global Compact, United Nations Guiding Principles on Business and Human Rights, ISO 26000 Guidance Standard on Social Responsibility and OECD Guidelines for Multinational Enterprises.

(4) In India

CSR in India has traditionally been seen as a philanthropic activity. And in keeping with the Indian tradition, it was an activity that was performed but not deliberated. In 2014, India became the first country in the world to have a mandatory CSR contribution legislation. In India, the concept of CSR is governed by clause 135 of the Companies Act, 2013, which was passed by both Houses of the Parliament, and had received the assent of the President of India on 29 August 2013. The CSR provisions within the Act is applicable to companies with an annual turnover of 1,000 crore INR and more, or a net worth of 500 crore INR and more, or a net profit of five crore INR and more. The new rules, which will be applicable from the fiscal year 2014-15 onwards, also require companies to set-up a CSR committee consisting of their board members, including at least one independent director. The Act encourages companies to spend at least 2% of their average net profit in the previous three years on CSR activities.

5.7.2 Other Countries

CSR in Australia

"Social responsibility is the responsibility of an organization for the impacts of its decisions and activities on society and the environment, through transparent and ethical behaviour that:

Contributes to sustainable development, including the health and the welfare of society

- Takes into account the expectations of stakeholders
- Is in compliance with applicable law and consistent with international norms of behaviour, and Is integrated throughout the organization and practiced in its relationships."

Corporate Social Responsibility or CSR has been debated since the early twentieth century, but there has been little agreement over its definition due to:

- Differences in national and cultural approaches to business
- Differences in motivation for CSR – doing it because it is morally correct or doing it because it makes good business sense
- Differences in disciplinary backgrounds, perspectives and methods of scholars engaged with CSR

Business View of CSR

Business leaders and management scholars have generally understood CSR as a response to business failures that have accompanied the astonishing growth in size, impact and power of modern corporations. That growth is characterized by the separation of ownership from control and the rise of modern management techniques. While modern management has created great efficiencies, it has also led to a dilution of individual responsibility that is generally only visible when business gets into strife.

Business failures in Australia, such as Australia's then biggest corporate collapse of HIH in 2001, together with crises in corporate accountability, such as the machinations of James Hardie to avoid liability for asbestos compensation by former workers, have led to a greater questioning here of the nature of corporate responsibilities.

Business leaders deal with CSR issues through specialist business organizations such as the Global Reporting Initiative, the UN Global Compact and the World Business Council for Sustainable Development. In contrast, scholarship related to CSR draws from many areas, including management, ethics, psychology, sociology, finance and accounting, sustainability, public affairs and communications.

CSR in Canada

Canada's enhanced Corporate Social Responsibility (CSR) Strategy, "Doing Business the Canadian Way: A Strategy to Advance Corporate Social Responsibility in Canada's Extractive Sector Abroad" builds on experience and best practices gained since the 2009 launch of Canada's first CSR strategy, "Building the Canadian Advantage: A Corporate Social Responsibility Strategy for the Canadian Extractive Sector Abroad."

The enhanced Strategy, announced on November 14, 2014, clearly demonstrates the Government of Canada's expectation that Canadian companies will promote Canadian values and operate abroad with the highest ethical standards. It also outlines the Government's initiatives to help Canadian companies strengthen their CSR practices and maximize the benefits their investments can provide to those in host countries.

Key elements of the enhanced CSR strategy include

Strengthened support for CSR initiatives at Canada's diplomatic network of missions abroad, aimed at ensuring a consistently high level of CSR-related service to the Canadian business community around the world, building networks and local partnerships with communities, and reinforcing Canadian leadership, excellence, and best practices in the extractives sector;

- Increased support and additional training for Canada's missions abroad to ensure Trade Commissioners and staff are equipped to detect issues early on and contribute to their resolution before they escalate;
- Re-focusing the role of the Office of the CSR Counsellor, including strengthening its mandate to promote strong CSR guidelines to the Canadian extractive sector and advising companies on incorporating such guidelines into their operating approach. The CSR Counsellor will also build on the work conducted at missions abroad by refocusing efforts on working to prevent, identify and resolve disputes in their early stages;
- In situations where parties to a dispute would benefit from formal mediation, the CSR Counselor will encourage them to refer their issue to Canada's National Contact Point (NCP), the robust and proven dispute resolution mechanism, guidedby the OECD Guidelines for Multinational Enterprises on responsible business conduct, and active in 46 countries;
- Companies are expected to align with CSR guidelines and will be recognized by the CSR Counselor's Office as eligible for enhanced Government of Canada economic diplomacy. As a

penalty for companies that do not embody CSR best practices and refuse to participate in the CSR Counselor's Office or NCP dispute resolution processes, Government of Canada support in foreign markets will be withdrawn;

- Inclusion of benchmark CSR guidance released since 2009, namely the United Nations' Guiding Principles on Business and Human Rights, and the OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas; and
- Flexibility to build awareness of a broader range of extractive sector-specific CSR guidance, including those developed in Canada, e.g., the Mining Association of Canada's Towards Sustainable Mining, and the Prospectors and Developers Association of Canada's e3 Plus.

CSR in United Arab Emirates

The concept of corporate social responsibility (CSR) in Dubai and the UAE has always been present from the earliest Islamic times, with people and organizations practising Islamic values, donating through philanthropy and Shariah compliant ways of commerce. In recent years, there have been worldwide initiatives to invest responsibly and focus on investing profits into community life and saving the environment.

CSR at government level

The UAE is among the countries in the region most interested in social welfare, through the provision of various public services aimed at maintaining an advanced level of social and economic stability. This has included the provision and development of infrastructure and municipal services, education and health.

In the net shell, reviewing the past decade, we can see that the language of CSR is changing for a good reason and the people are getting more and more aware as well as willing to implement the idea. This search has led its way to new ideas and has developed an expectation of what a socially responsible corporation has to be. The alarming situations in the global village are highly demanding a strategic implementation of CSR into the society and demand the corporate entities to be an active part of the ideology.

5.8 CORPORATE SOCIAL RESPONSIBILITY UNDER COMPANIES ACT

Corporate Social Responsibility (CSR) assumes significance as it permits companies to engage in projects or programs related to activities related to social welfare and improvement enlisted under the terms of Companies Act, 2013. There is an element of flexibility in company activities by allowing them to select their preferred CSR engagements that are in agreement with the overall CSR policy of the company. In this article, we review the applicability of CSR, policy of CSR, role of Board of Directors and activities of CSR.

Definition of Corporate Social Responsibility (CSR)

The term Corporate Social Responsibility or CSR has been defined as under, but is not limited to:

- Projects or programs with reference to activities that are specified in the Schedule; or
- Projects or programs related to activities undertaken by the Board in pursuance of recommendations of the CSR Committee according to the declared CSR policy subject to the condition that such policy covers subjects explained in the Schedule.

Applicability of Corporate Social Responsibility to Companies

Corporate Social Responsibility is required for all companies viz. private limited company, limited company. The following companies are necessary to constitute a CSR committee:

- Companies with a net worth of Rs. 500 crores or greater, or
- Companies with a turnover of Rs. 1000 crores or greater, or
- Companies with a net profit of Rs. 5 crores or greater.

If any of the above financial strength criteria are met, the Corporate Social Responsibility (CSR) provisions and related rules will be applicable to the company. These companies are required to form a

CSR committee consisting of its directors. This committee oversees the entire CSR activities of the Company.

Note: Corporate Social Responsibility is a requirement for companies meeting the above criteria. On the other hand, **Section 8 Companies are incorporated** solely for not-for-profit purposes.

Role of Board of Directors in CSR

The board of directors of a company plays a significant role in CSR activities of the company. The role of Board is as follows:

- Approval of the CSR policy.
- Ensuring its implementation.
- Disclosure of the contents of CSR policies related to its report.
- Placing the same on Company's website.
- Ensuring that statutory specified amount is spend by the company with reference to CSR activities.
- It's significant to note that there is no penalty if the particular amount is not spent on CSR activities. In such case, the board's report must identify the reason for such short spending.

CSR Committee and Policy

All qualifying company required to have a CSR committee are required to spend at least 2% of its average net profit for the directly preceding 3 financial years on CSR activities. Additionally, the qualifying company shall be necessitated to comprise a committee (CSR Committee) of the Board of Directors (Board) comprising of 3 or more directors. The CSR Committee will prepare and recommend to the Board, a policy which will specify the activities to be undertaken (CSR Policy); advocate the amount of expenditure to be incurred on the activities referred and monitor the CSR Policy related to the company. The Board will take into account the recommendations made by the CSR Committee and support the CSR Policy of the company.

Activities permitted under Corporate Social Responsibility (CSR)

The following activities can be performed by a company to accomplish its CSR obligations:

- Eradicating extreme hunger and poverty
- Promotion of education
- Promoting gender equality and empowering women
- Reducing child mortality
- Improving maternal health
- Combating human immunodeficiency virus, acquired, immune deficiency syndrome, malaria and other diseases
- Ensuring environmental sustainability,
- Employment enhancing vocational skills, social business projects
- Contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government or the State Governments for socio-economic development, and
- Relief and funds for the welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women and such other matters as may be prescribed.

Importance to Local Areas and Neighborhoods

Under the terms of Companies Act, preference must be given by companies in its CSR activities to local areas and the areas where the company operates. Company may possibly also choose to link with 2 or more companies for fulfilling the CSR activities provided that they are competent to report individually. The CSR Committee will also prepare the CSR Policy in which it includes the projects and programmers which is to be undertaken, organize a list of projects and programmers which a company plans to embark on during the execution year and also focus on integrating business models with social and environmental priorities and process for the reason of creating share value. The company can in addition make the annual report of CSR activities in which they declare the average net profit for the 3 financial years and also approved CSR expenditure but if the company is not capable to spend the minimum required

expenditure the company has to provide the reasons in the Board Report for non-compliance so that there are no related penal provisions.

SUMMARY

This unit is summarizing in the corporate social responsibility of the core stand of the Indian culture. Corporate have Social Responsibility (CSR) targets to help to improve society living. CSR referring to way that businesses are managed to bring about an overall positive impact on the communities, cultures, societies and environments in which they are operate. A business doesn't exist in isolation simply as a way of making money. Customers, Suppliers and local Community are all affected by business. Corporate Social Responsibility takes all this into account and helps the business to create and maintain effective relationship with your stakeholders. Much has been done in recent years to make Indian Entrepreneurs aware of social responsibility as CSR is an important segment of their business activity but CSR in India has yet to receive widespread recognition. Corporate Social Responsibility (CSR) is a form of social obligation a Company towards society at large. The Indian government has been trying to make it mandatory for companies to spend at least 2% of net profits on CSR. In India, though the corporate understand their accountability towards the society and are willing to take initiatives for the betterment, it becomes difficult for them to reach the grassroots level. Corporate Social Responsibility Practices in India sets a realistic agenda of grassroots development through alliances and partnerships with sustainable development approaches. Here researcher is to study the Corporate social responsibility is must be essential and useful to current scenarios in IT business sector with special reference to Infosys.

QUESTIONS

Conceptual Type

1. What is Social Responsibility?
2. What is CSR?
3. What is the component of CSR?

Analytical Type

1. What is Social Responsibility? Meaning & Definition
2. What is CSR and what are the Application.
3. What is the concept of CSR of India?
4. What are the key components of CSR?
5. What is the Social Responsibility of different countries?