CHAPTER- III
THE CONCEPT OF CORPORATE GOVERNANCE AND CORPORATE SOCIAL RESPONSIBILITY

The concept of corporate governance has existed from the earliest days of social organization and is evolving. Effective corporate governance structures encourage corporations to create value, through entrepreneurialism, innovation, development and exploration, and provide accountability and control systems commensurate with the risks involved. Corporate governance is the system of rules, practices and processes by which a company is directed and controlled. It essentially involves balancing the interests of the many stakeholders in a company - these include its shareholders, management, customers, suppliers, financiers, government and the community. Since corporate governance also provides the framework for attaining a company's objectives, it encompasses practically every sphere of management, from action plans and internal controls to performance measurement and corporate disclosure. Corporate governance includes the processes through which corporations' objectives are set and pursued in the context of the social, regulatory and market environment. The interest of the modern corporations in the corporate governance practices, particularly in relation to accountability, increased because of the high-profile debacles of a number of large corporations during 2001–2002, most of which involved accounting fraud.

Corporate governance extends beyond corporate law. When it is practiced under a well-laid out system, it leads to the building of a legal, commercial and institutional framework and demarcates the boundaries within which these functions are performed. Its fundamental objective is not mere fulfillment of requirements of law but in ensuring commitment of the board and its senior officers in managing the company in a transparent manner for, inter alia maximizing long term shareholders value. There is plethora of laws in this regard but what is required is the effective enforcement of these laws.

The framework of corporate governance is an important component affecting the long-term prosperity of companies. The corporate environment not

static but evolving hence, In this context it is important to overhaul the corporate market practices to ensure that they respond appropriately to the changing environment. In this dynamic environment, the systems of corporate governance also need to evolve. When an investor invests money in a corporate, he expects the board and the management to act as trustee and ensure the safety of the capital which will fetch the investor periodical higher returns. In this regard, investors expect management to act in their best interests at all times and adopt good corporate governance practices. Corporate governance is the acceptance by management of the inalienable rights of shareholders as the true owners of the corporate and of their own role as trustees on behalf of the shareholders. It is about making a distinction between personal and corporate funds in the management of a company. The concept of corporate governance has assumed importance both in the public and the private sector. It is used to monitor whether outcomes are in accordance with plans and to motivate the organization to be more fully informed in order to maintain or alter organizational activity. It is the mechanism by which individuals are motivated to align their actual behaviours with the overall participants. The corporate governance has to take care of the interest of the employees, past, present and future which comprises the whole life cycle including planning future needs, recruitment, training, working environment, severance and retirement procedures.

Corporate governance is efficient supervision that encourages doing everything better and protects the interests of the company while conforming to all established laws and ethics.

3.1 Development of the concept of corporate governance in various countries

3.1.1 Argentina

A paper by Apreda (2001) provided evidence on two issues. First, it supported the allusion that there has been a marked shift in ownership and control in Argentina from large, family-owned domestic companies toward foreign groups and investment funds. Second, the paper provided evidence that while coping with corporate governance issues, Argentina has followed the common law countries'
tradition, fostering a capital market-based financial system and swapping its corporate governance practices outright. The paper discussed the historical system of corporate governance in Argentina and its process of reform in recent years. The country was characterized by substantial family control and state ownership of companies, inefficient corporate operations and a closed economy. In the 1990s this situation changed dramatically with Argentina opening its borders to trade and investment and attempting to improve its system of corporate governance. Reform has included a privatization programme and a series of reforms of company law.

3.1.2 Australia

Stapledon\(^3\) (1996) compared the role of institutional investors in Australia with that of institutional investors in the UK. He explained that Australia has been characterized traditionally as having an outsider system of corporate governance, possessing the same basic characteristics as the UK. Despite this general similarity, there are significant differences between the two countries with respect to ownership structure and level of shareholder involvement in companies. The quoted corporate sector is not as significant in Australia as it is in the UK. Further, there is a higher incidence of founding family and intercompany ownership in Australia than in the UK. As in the UK, the two largest categories of institutional investor are the occupational pension funds and insurance companies (Stapledon, 1996). The early 1990s witnessed a growth in shareholder activism in Australia, with the introduction of the Australian Investment Managers’ Group (AIMG), which provides a mechanism for collective shareholder action. Stapledon (1996) compared the level of institutional investor involvement in Australian companies with that in the UK, concluding that until the mid-1990s Australian shareholder activism was far less evident. He considered this was because Australian companies were effectively immune from intervention by institutional investors, as they tended to have a significantly large non-institutional shareholder base that controlled the company. Australia has its own code of corporate governance practice deriving from the Bosch Report (1995). Bosch Report (1993) described

the development of the Bosch Report. From his discussion it seems that the Bosch Report followed the UK Cadbury Report (1992) closely.

### 3.1.3 Bahrain

Although Bahrain does not have a code of best practice for corporate governance, companies are established according to the Commercial Companies Law 2001 (Hussain and Mallin, 2002). This law requires that companies have a board of directors that acts in a responsible manner and that shareholders exercise their voting rights. In 2001 Hussain and Mallin conducted a questionnaire survey to investigate the status of corporate governance in Bahrain. They sent the questionnaire to all companies listed on the Bahrain Stock Exchange Market, finding that listed companies in Bahrain have in place some of the features of international corporate governance 'best practice'. However, they did question the effectiveness of the nomination committees and felt that company directors tended to be entrenched in their attitudes.

### 3.1.4 Belgium

In a paper examining corporate governance in Belgium, Wymeersch (1994) explained that Belgian companies were generally secretive and unaccountable to the outside world until a process of reform in 1991, when a series of amendments to Belgian company law focused on minority shareholder protection and rights. Also, corporate disclosure has been improved substantially. This is another example of an insider-type system becoming more market-oriented. Institutional investors in Belgium constitute about 20% of shareholding, with shareholder activism on the rise. However, the market for corporate control through takeover has been relatively undeveloped. There is a Belgian code of corporate governance, the Cardon Report (1998).

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6 Corporate governance for Belgian listed companies (*The Cardon Report*) December 1998.
3.1.5 Canada

Daniels and Waitzer\(^7\) (1993) described the Canadian system in detail, emphasizing importance of improving corporate governance in order to remain globally competitive and to attract foreign investment. An in-depth review of corporate governance was performed by Daniels and Morck in 1996\(^8\), which considered various policy options for the future development of Canadian corporate governance. Their study showed that there was an element of outsider-type corporate governance in Canada, as some of Canada's largest companies and all its chartered banks were widely held by a large number of small shareholders, each of whom had little effective control over managerial decision making. However, they also showed that this type of ownership structure was not common, quoting evidence that only 16% of the 550 largest Canadian companies were placed in this mould. Indeed, research has shown that most Canadian companies were not widely held by investors. Rao and Lee-Sing found that in more than three-quarters of the Canadian companies they studied, one large shareholder controlled at least 20% or more of the voting shares. Corporate ownership was found to be concentrated significantly in the hands of company management, leading to management control over director appointments corporate decision making. Although this situation removes the traditional agency problem to some extent, other problems are introduced, as managerial control can lead to the appointment of board members for reasons of friendship rather than merit.

Daniels and Morck (1996) stressed that improving corporate governance in Canada was essential; arguing that its absence would erode public confidence in Canada's financial markets and depress company share prices. This would result in Canadian companies experiencing difficulties in raising equity capital. These arguments may be applied to countries around the world in an attempt to support corporate governance reform. One way of improving corporate governance is to encourage monitoring of company management by institutional investor. Institutional investors controlled over 38% of Canadian companies in the mid-

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\(^8\) Jill Solomon and Aris Solomon, Corporate Governance and Accountability 163 (Wiley India P LTD., New Delhi).
1990s, and that proportion has increased gradually. Their influence on corporate governance is likely to increase commensurately, as it has in the UK, Australia and other countries. Corporate governance reform in Canada was encouraged by the publication of the Dey Report\(^9\) (1994) and by the publication of a series of governance standards by the institutional shareholder representative group, Pensions Investment Association of Canada (PIAC, 1998).\(^{10}\)

### 3.1.6 Chile

Following an upgrade of the legislative and regulatory framework dealing with corporate governance, Chile has become a standard setter for the entire Latin American region. Chile's system of corporate governance fits into the traditional insider model, with concentrated corporate ownership and pyramidal ownership structures. The stock market is quite large, with 249 companies listed on the Santiago Stock Exchange at the end of 2001. Fremond and Capaul\(^{11}\) concluded that Chile complied reasonably well with the OECD Principles for good corporate governance. Seven pension funds and insurance companies held 30% of total assets at the end of 2001. The evidence suggests that pension funds have influenced corporate governance in Chile, urging better disclosure of information by companies, as well as lobbying for the protection of minority shareholder rights. The country's legal system is based on French law, which is typical of insider-type corporate governance systems. However, a complete overhaul of company law in 2000 has strengthened the corporate governance framework, focusing on improving shareholder protection. However, in relation to corporate accountability to a broad group of stakeholders, Chile seems to be falling short as: Although the legal framework protecting stakeholders is fairly well developed, Chilean corporations still too often relate to their stakeholders in a confrontational

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\(^9\) The Dey Report The first comprehensive and relatively recent discussion of enhanced corporate governance seems to be the 1994 report, “Where Were the Directors? Guidelines for Improved Corporate Governance in Canada” (the “Dey Report”). The Dey Report was innovative when it first appeared and led to the TSX in 1995 adopting what were then viewed as extensive corporate governance guidelines. These guidelines have been effective in raising the consciousness in Canada of the importance of good corporate governance.\(^9\) However, the SOX Act and its antecedents discussed below are significantly more demanding and extensive than the Dey Report and than the TSX’s existing corporate governance guidelines.

\(^{10}\) Supra n. 10.

\(^{11}\) Jill Solomon and Aris Solomon, *Corporate Governance and Accountability* 164 (Wiley India (P) LTD., New Delhi).
manner, perpetrating the idea that entrepreneurs and stakeholders are rent-seeking individuals. Anecdotal evidence indicates that this approach often leads to corporate shortsightedness, which may jeopardize important opportunities for future economic development in Chile.

3.1.7 China

As China is still a communist state, progress in the capital markets and in the area of corporate governance has been slower than in several other East Asian countries. However, as in many of the Central and Eastern European economies there has been a significant move toward a more liberal market system and a more transparent and 'Western' corporate governance system. In China, until recently, companies were owned chiefly by the Government. Consequently, China fits into the insider mould, with little separation of ownership and control. The Government owned Chinese companies and ran them. Recent reforms have initiated extensive privatization of these State Owned Enterprises (SOEs). Tarn (2000) discussed the state of corporate governance reform in China and explained how SOEs have been privatized in detail. SOEs were restructured into shareholding companies whose shares could then be traded on one of the two Chinese stock markets, the Shanghai and Shenzhen, which only opened in 1990 and 1991, respectively. One of the main corporate governance problems for Chinese companies has been to create a separation between company management and government, because the Government, as principal owner of Chinese companies, has traditionally had a substantial influence over company activities and decision making. The notorious agency problems associated with outsider-type systems are now emerging in China, as they are in all countries with nascent equity markets and whose companies’ capital structures are undergoing transformation. At face value it seems that corporate governance improving considerably in Chinese companies. Company law in China specifies three levels of control over company activities: the shareholders’ general meeting; the board of directors and supervisors; and company management. However, despite corporate governance reform progressing quickly there are evident weaknesses.12

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12 (Stven Shi and Drake Weisert, 2002) see Jill Solomon and Aris Solomon, Corporate Governance and Accountability 164 (Wiley India (P) LTD., New Delhi).
shareholders’ AGM has been considered impotent as managers tend to rubber-stamp decisions they made earlier, thus gaining control over meetings. There is in practice a negligible amount of shareholder democracy. Further, insiders tend to gain positions on the boards of directors and supervisory board and simply become puppets for the controlling parties. Minority shareholders have few rights and their concerns are usually ignored by majority shareholders. As in all the countries we are studying, reform involves a long and difficult process takes many years, even when the systems and structures are in place.

### 3.1.8 The Czech Republic

Mallin and Jelic (2000)\(^{13}\) summarized corporate governance changes in three countries in Central and Eastern Europe, making comparisons between the programmes of reform between the countries involved. They highlighted the commonalities and differences between the processes of change in the countries involved. For the Czech Republic they explained that during the communist regime Czechoslavakia was more tightly controlled than other Central and Eastern European countries. An agenda for corporate governance reform was instigated in 1991 that needed to be extremely ambitious in order to achieve privatization and an active market for corporate control. Shops and small business units were the initial focus of privatization programme, with large-scale businesses being included over time. Despite reform, the state has retained substantial control over privatized Czech companies. In 1991, 400 Investment Privatization Funds (IPFs) were created that were intended to mimic Western mutual funds. Coffee (1996) found that IPFs and individual investors were mainly involved in the privatization program. According to Mallin and Jelic (2000) it was unclear whether IPFs or banks will evolve as the dominant forces in Czech corporate governance.

An assessment of corporate governance in the Czech Republic was carried out by the World Bank and the International Monetary Fund (IMF, 2001). They explained that a major package of legislation affecting corporate governance was approved by Parliament for January 2001. This package included extensive changes to the country's Commercial Code, the Securities Act and the Auditing

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\(^{13}\) Jill Solomon and Aris Solomon, Corporate Governance and Accountability 165 (Wiley India ( P ) LTD., New Delhi).
Act. As with most countries we are considering, changes to the legal framework are one of the main ways in which corporate governance reform is orchestrated, as a country's legal system is one of the most important factors influencing corporate governance. The assessment (IMF, 2001) stated that the changes to the Commercial Code were extensive, improving significantly the internal corporate governance mechanisms in the Czech Republic. However, they also suggested that, despite such changes, a number of institutional deficiencies implied that genuine improvements in corporate governance would take time. Such institutional deficiencies included a slow and inefficient court system. The report ended on a positive note:

When implementation and enforcement of the new laws and regulations are strengthened, the Czech Republic will observe most of the principles on corporate governance.

3.1.9 France

The control of French companies tends to be divided between the state, company management and families. There is little dispersion of Ownership and the system is clearly closer to the insider, rather than the outsider, model of corporate governance. The state has a powerful role in French companies, termed *dirigisme*, partly due to their necessary involvement in the redevelopment of industry following World War II (Monks and Minow, 2001)\[^{14}\]. State control has included restructuring state-owned industries for policy purposes and ensuring that key industries remained under state control. Even listed companies are under state influence, as French financial institutions, such as banks and insurance companies, are state owned and/or controlled, and represent the major capital providers to private companies in France. An estimated two-thirds of French listed company shares are characterized by cross-company shareholdings, termed the *verrouillage* system. French boards are strong and control decision making in companies. They also interlock to a high degree. Monks and Minow (2001) provided statistics to show that, in 1989, 57 people accounted for one-quarter of

\[^{14}\] Robert A.G. Monks and Nell Minow are founders of Governance Metrics International, the leading independent research firm dedicated to corporate governance. Formerly principals of the Lens Fund and officers of Institutional Shareholder Services.
all the board seats of the largest 100 listed companies in France. This is clear indication of director control. According to company law, French companies can choose either a unitary board (as in the UK) or a two-tier board structure (as in Germany), although most opt for a unitary board.

France has produced two codes of best practice in order to promote corporate governance reform. The evidence suggests that companies have embraced the recommendations of the first report, as 92% of companies were applying the recommendations by 1999. Also, 30% of directors were classified as independent and 90% of boards had audit, remuneration and nomination committees.\(^{15}\)

### 3.1.10 Germany

German corporate governance has attracted significant interest from academics, as the German economy was extremely successful following World War II. Many attributed this success to the inherent differences between the German system of corporate governance and the Anglo-American system. The merits of relationship-based, insider corporate governance system that has tradition characterized German corporate governance have been heralded by many authors. The notorious short-termism problem, blamed for constraining British industry, was less evident in Germany, where long-term relationships between companies and their providers of finance led to long-term investment. This allowed companies to invest in long-term projects and enjoy a more secure financial environment. In more recent times, such 'advantages' have become disadvantages for German companies, as they have not been able to attract capital from institutional investors in global markets, due to 'parochial governance practices that have obstructed shareholder rights'. One initiative aimed at improving German corporate governance through better corporate transparency was the publication of a report by the Deutsche Bundestag (1998). Further, Germany produced corporate governance code of best practice in January 2000, followed by an updated version in September 2001. The code's stated aims were to present essential statutory regulations for the management and governance of

\(^{15}\) Jill Solomon and Aris Solomon, *Corporate Governance and Accountability* 166- 167 (Wiley India (P) LTD., New Delhi).
German listed companies, as well as to contain internationally and nationally recognized standards for good and responsible governance. Clearly, achieving harmonization with internationally acceptable standards was a main driver of reform in Germany, as in most countries. The German system of corporate governance is significantly different from Anglo-American model in a number of respects. German companies are characterized by a two-tier board and significant employee ownership. The supervisory board, in theory, is intended to provide a monitoring role. However, the appointment of supervisory board members has not been a transparent process and has therefore led to inefficient monitoring and governance in many cases. Further, German corporate governance has been characterized traditionally pyramidal ownership structures, with companies owning each other through series of cross-shareholdings. There has also been a strong tendency toward employee representation, as a result of the Co-Determination Act of 1976, which stipulated that employees should be involved in the corporate governance mechanisms being represented on supervisory boards. However, companies have rallied again the idea of co-determination since the 1970s, considering it infringed ownership right. Employee representation at the heart of companies derives from an extremely different cultural attitude toward corporate governance from that operating in Anglo-Saxon economies. It is far more in keeping with a stakeholder, than a pure shareholder, approach to corporate governance. There are strong market forces pressuring for change in Germany. International institutional investment and increasingly open economies are forcing countries such as Germany to become more market-oriented. There were moves toward a more equity-based system, with shareholders' involvement becoming increasingly important.16

3.1.11 Hong Kong

Although, Hong Kong appears to have an outsider system of corporate governance, it really has an insider system. The Hong Kong companies have imitated the UK model of a joint stock company. They have a broad base of owners, who delegate management of the business to a small number of company directors. However, the reality is very different. Ownership is not by a diverse

16 Supra n. 15 at 167-168.
range of outsiders who dominate control over the companies. Rather, in all companies, shareholding is concentrated and a small group of shareholders, or even a single shareholder, dominates the investee company management. Indeed, he states that up to 75% of a company's shares can be owned by management and friends of the management. There is therefore very little true separation of ownership and control, despite appearances. Two sets of corporate governance guidelines have been published in Hong Kong to promote corporate governance reform in the area of audit committee formation (HKSA, 1997) and boards of directors (SEHK, 1997).

**3.1.12 Hungary**

The corporate governance system of Hungary is at an evolving stage. Hungary was more liberal than other economies in Central and Eastern Europe. A series of banking and accounting reforms took place in 1991. A privatization programme was initiated by the communist Hungarian Government in the early 1990s, and this programme of reform increased in pace as communism was dispensed with. As a result of the reforms the number of limited liabilities rose from 450 in 1988 to 79,395 in 1994. In the newly evolving Hungarian corporate governance system, banks appear to be taking on a major role.

**3.1.13 India**

India's Bombay Stock Exchange has the largest number of listed companies in the world. Yet, despite the size of the stock market in India, ownership remains concentrated in families and an insider-dominated structure seems to persist. However, the Indian system of corporate governance is 'hybrid' of the outsider and insider model, as small shareholders participate in corporate governance. There is also significant institutional investor involvement in listed companies. According to Sarkar and Sarkar (2001), indeed, there exist a positive relationship between block shareholding by institutional investors and company value. They also provided evidence that the principal shareholders of Indian listed companies were: directors and their relatives, corporate bodies, foreign investors,

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17 Supra n. 15 at 168.
18 Ibid.
19 Jill Solomon and Aris Solomon, Corporate Governance and Accountability 169 (Wiley India (P) LTD., New Delhi).
Government-controlled financial institutions and the public. Their statistics indicated that about 43% of all sample companies had equity ownership by corporate bodies in excess of 25%. Directors and their relatives held about 21% of shares in private companies. This pattern of ownership results from predominance of family ownership in listed companies.

India is following the global trend in reforming its corporate governance system. As in other countries a series of corporate scandals focused keen attention on corporate governance weaknesses. However, as a former colony of Britain, India has a UK-style legal system that offers a reasonable level of protection to minority shareholders in comparison with other East Asian countries. Since second half of the 19th century, Indian industry has generally followed an English common law framework of joint stock limited liability. The Confederation of Indian Industry (CII, 1998) has produced a code of practice aimed at reforming corporate governance. The adoption of a structural adjustment and globalization programme by the Indian Government in 1991 forced corporate governance policy attention on corporate governance issue. A survey of company directors in India showed that they were keen on reforming corporate governance in the wake of the Asian crisis and were focusing on improving the board of directors and investor relations.

3.1.14 Indonesia

Indonesia represents a corporate governance system in East Asia with an emerging stock market. Most companies are family-owned and controlled. Indonesia's corporate governance fits neatly into the insider-dominated model and demonstrated severe cases of minority shareholder wealth expropriation following the Asian financial crisis. For example, managers diverted funds in order to finance a political party in the Indonesian PT Bank Bali, between 1997 and 1998. Further, group managers transferred currency losses from a manufacturing company to a group-controlled bank in Sinar Mas Group between 1997 and 1998, which effectively represented expropriation of wealth from the bank's minority
shareholders and creditors. These cases present a clear mandate for corporate governance reform, as in many other countries.\textsuperscript{20}

3.1.15 Italy

Italian corporate governance fits well into the insider mould, with companies being predominantly family-owned, or owned through a structure of cross-company shareholdings. Further, the shareholdings are extremely concentrated. The main shareholder in Italian companies (termed a blockholder) exerts control over the company's management. Melis (2000)\textsuperscript{21} described the insider system as 'relationship-based' and discussed the possibility that Italian law has favoured family control rather than shareholder protection. This has deterred small shareholders from investing in Italian companies. Indeed, Italian corporate governance mechanisms have been found to be so underdeveloped that they significantly retard the flow of external capital to firms (see Shleifer\textsuperscript{22} and Vishny\textsuperscript{23} 1997). The process of corporate governance reform in Italy has been called the Draghi Reform, a new corporate law produced in 1998. The Draghi Reform was aimed at regulating financial markets and corporate governance in listed companies and should lead to better investor protection. It is not a code of practice like Cadbury but is rather a legally binding series of amendments to company law. This is interesting as it seems that countries with less developed market systems (which are categorized as strongly insider in nature) have had to develop mandatory, regulated corporate governance reforms, rather than the voluntary codes that have been applied in more market-based, developed economies. In this way the nature of codes of practice reveal much about the

\textsuperscript{20}Ibid.
\textsuperscript{21}Jill Solomon and Aris Solomon, Corporate Governance and Accountability 170 (Wiley India (P) LTD., New Delhi).
\textsuperscript{22}Robert Ward Vishn, is an American economist and is the Myron S. Scholes Distinguished Service Professor of Finance at the University of Chicago Booth School of Business. He was the Eric J. Gleacher Distinguished Service Professor of Finance at the University of Chicago Booth School of Business. He received his A.B. with highest distinction (economics, mathematics, and philosophy) from the University of Michigan in 1981 and Ph.D. (Economics) from Massachusetts Institute of Technology in 1985.
\textsuperscript{23}Andrei Shleifer, is a Russian American economist and Professor of Economics at Harvard University, where he has taught since 1991. Shleifer was awarded the biannual John Bates Clark Medal in 1999 for his seminal works in three fields: corporate finance (corporate governance, law and finance), the economics of financial markets (deviations from efficient markets), and the economics of transition.
character of countries' traditional systems and state of their financial markets. It is evident that emerging markets are reforming corporate governance by means of changes to their company law. Overall, Italy has characterized by an almost non-existent market for corporate control and capital market orientation.

3.1.16 Japan

Japan fell traditionally into the insider-dominated group and had a 'credit-based' financial system, as the economy was characterized by inter-company shareholdings, inter-company directorships and frequently substantial bank involvement. Japan's economy, despite the reorganization following War II is still to some extent characterized by the zaibatsu, a group of family-run businesses that emerged as early as the 17th century. These business enterprises have since evolved into the keiretsu, which are related closely through share ownership to one or more banks. In this type of system, there is little takeover activity and shares are not traded as frequently in market-based economies. More recently, the trend has been toward a more market-dominated Japanese system of corporate governance, perhaps as a result of pressures arising from recent economic problems. However, Japan and other East economies still retain a different attitude toward business from Anglo-American-style economies. East Asian and particularly Japanese capitalist structures emphasize trust, continuity reputation and cooperation in economic relationships. Competition is ferocious, cooperation is extensive; the juxtaposition of apparently inconsistent forms of behaviour may strike those schooled in Anglo-American capitalism as irrational, but for the Japanese the tension actually enhances the strength of each. There is even a widely quoted phrase for it—kyoryoku shi nagara kyosa—literally 'cooperating while competing', so that out of the subsequent chaos comes harmony.

A pattern is emerging in Japan that is being repeated in many countries around the world. The system of corporate governance traditionally dominated by 'banks and bureaucrats' is being replaced gradually by a market-oriented system. A decade ago, when the keiretsu system of complicated intercompany shareholdings was still flourishing, companies were protected from shareholder influence. A series of aggressive liquidations of banks holdings in Japanese companies is breaking the close ties that banks and companies have traditionally
enjoyed in Japan. There has also been a transformation of corporate ownership structures. Institutional investors are now estimated to own almost three-quarters of the equity market in Japan, reflecting the ownership structure in the UK. Further, Japanese institutional investors are beginning to recognize the financial benefits that may be gained from improved corporate governance. For example, Sparx Asset Management, Japan's only listed independent fund manager, has launched a $200 million fund. The fund’s management is based on actively improving the corporate governance of investee companies and has been inspired by the involvement of CalPERS, the activist US pension fund. Therefore, the Japanese system of corporate governance is gradually moving much further toward a market-based, outsider-dominated system of ownership and control.

Despite recent changes, the empirical evidence indicates that Japan continues to fit more closely within an insider than an outsider system, if we consider the empirical evidence. Significant concentration of ownership in Japanese companies has been found by a number of studies. Although the corporate governance system is increasingly dominated by financial institutions, it is also characterized by concentration of ownership rather than wide dispersion, which implies that the agency problems associated with the market-based model are less prominent.

Japan has issued guidelines on exercising voting rights (Pension Fund Corporate Governance Research Committee, 1998) and a series of corporate governance principles (Corporate Governance Committee, 1998).

3.1.17 Jordan

Jordan's system of corporate governance is insider-oriented with most companies the Amman stock exchange being owned predominantly by founding families. Accountability and transparency are almost non-existent with minority shareholders' rights being insignificant. There is currently no code of practice for corporate governance in Jordan. However, corporate governance reform is high on the agenda in Jordan. The newly formed Arab Business Council is likely to focus
attention on corporate governance issues, as reform will help to boost investor confidence in the Middle East.\textsuperscript{24}

3.1.18 Malaysia

Traditionally, Malaysia typifies the insider-based model of corporate governance, with most companies owned and controlled by founding families. Corporate governance problems have been blamed in part for the way in which Malaysia (and other East Asian economies such as South Korea) succumbed to the financial crisis of 1997. This realization has inspired corporate governance reform throughout East Asia. A policy document aimed at improving corporate governance practice in Malaysian companies was produced in 1999 (High Level Finance Committee Report on Corporate Governance, 1999). The most salient characteristic of the Malaysian code was its mandatory nature. Recall that the Combined Code (2003) in the UK is essentially voluntary, following the spirit of 'comply and explain'. Regulation appears to have been more necessary in Malaysia, as in the past minority shareholders have had few rights. It seems that the efforts taken by Malaysian regulators and market participants to improve the country's corporate governance framework have improved Malaysia's standing in the region, according to the results of a survey carried out by the Kuala Lumpur Stock Exchange (KLSE) and PricewaterhouseCoopers (KLSE, 2002). Further, the survey provided strong evidence that Malaysia's corporate governance practices have improved since the code's publication. Specifically, institutional respondents to the survey suggested that a greater separation of company management and ownership had been achieved, as well as clearer definition of the roles and responsibilities of managers and directors, greater focus on internal control and increased disclosure of corporate non-financial information. Attention has also been paid to encouraging growth in shareholder activism, with the establishment of the Minority Shareholder Watchdog Group by some large institutional investors.

3.1.19 The Netherlands

The Dutch system of corporate governance is characterized by a two-tier board. This is common to a number of countries worldwide. Under this structure,

\textsuperscript{24} Supra n. 23 at 173.
overall management is carried out by the executive board. This board is responsible for day-to-day running of the business and general corporate operations. There is then a supervisory board that acts like a watchdog. It supervises the conduct of the executive board and provides advice when necessary. The supervisory board, known as the Struktuurvennootschap, is compulsory for large companies but optional for smaller companies. A report on corporate governance in The Netherlands was printed in the journal *Corporate Governance: An International Review*. The report summarized the recommendations for corporate governance reform arising from the Committee on Corporate Governance in October 1996. This Committee produced a report that dealt with: the profile, constitution, duties, appointments and remuneration of the supervisory board; procedures of the supervisory board; the work of the board of directors; the functioning of the AGM and investors' role in the organization; compliance with the Committee's recommendations; the function the auditors; and corporate disclosure. The report is commonly referred to as the Peters Report (Peters Committee, 1997).

3.1.20 Nigeria

Before Nigeria became independent, company management was not controlled or monitored by external agents but that in recent years this has changed. Nigerian companies are being increasingly called on to increase accountability. The Commonwealth initiatives aimed at improving corporate governance, embodied in their *Principles for Corporate Governance in the Commonwealth: Towards Global and Economic Accountability*, are having a substantial impact on corporate Nigeria and other Commonwealth countries.

3.1.21 Poland

Lawniczak\(^25\) (1997) described the process of stock market creation that has occurred as a result of a government policy to liberalize the Polish economy. Lawniczak explained that the Polish model of mass privatization was characterized by the development of National Investment Funds (NIFs). The

introduction of this process was the 30 April 1993 Law on National Investment Funds and their Privatization. This assigned over 500 small and medium-sized companies to 15 NIFs that control 60% of the company’s overall. The state retained 25% corporate ownership and corporate employees were given the remaining 15%. The role of the NIFs has been to invest in companies created by restructuring state-owned enterprises and in other Polish companies. The mass-privatized companies were not sold but transferred free of charge to the NIFs. The eventual aim is for the ownership of shares under the NIFs to be transferred to the general public (individual investors). Shares should eventually be traded freely on the Warsaw Stock Exchange. However, the road toward a free market in Poland has been rocky. There have been severe problems of conflicts arising between management firms and companies' supervisory boards. Indeed, the evolving corporate governance system has been termed 'Bermuda Triangle', which describes the problems involved in the complicate NIF governance relationship. Koladkiewicz\textsuperscript{26} (2001) discussed the most recent developments in the process of corporate governance reform in Poland. She concluded that in the past 10 years the basic skeleton of a new corporate governance system has been constructed. She showed that Polish banks have been prepared to provide companies with necessary capital but have not wanted to take on an active ownership role. She also considered that there are still problems arising from the close relationship between companies' supervisory boards and the political environment. She indicated that there should be less control of corporations' activities by the state.

3.1.22 Russia

Since the end of the Cold War, Russia has been opening up its financial markets and the Russian stock market has been developing. In a way, the changes in Russia have probably been too fast and furious for the economy to keep up with. The legal framework has been trying to catch up with the pace at which a market economy has been developing in Russia. In 1996, Yeltsin, the President of the Russian Federation, produced a document aimed at enforcing greater

\textsuperscript{26} Izabela Koladkiewicz, “Building of a Corporate Governance System in Poland: initial experiences” 9 \textit{CGIR} 228-237 (2001).
shareholder rights. Jesover discussed corporate governance reform in Russia, explaining that the collapse of the communist state led to rapid embrace of a decentralized, free economy. However, businesses are struggling to adapt to the fast pace of change. The 1990s witnessed wide-scale privatization in Russia. Although a large proportion of Russian companies were transferred from the public to the private sector, the upheaval created many problems. Instability in ownership rights ensued. Most companies are characterized by an insider system whereby the company is controlled by a controlling shareholder. Monitoring of company activities by outsiders, such as institutional investors, has been weak. Jesover (2001) argued that, unless Russia improved corporate governance substantially, Russian companies would not be able to attract finance from abroad. Foreign investment is essential for the development of the Russian economy in the long term and its accession to global competitiveness. The author also went through the OECD Principles for 'good' corporate governance and considered how they matched up with the situation in Russia. The paper suggested that there had been wide abuse of power by Russian companies and many examples of corporate misconduct, which have had a devastating impact on the country's international reputation. The conclusion of the paper was that the reforms would take a long time because they involve not just institutional and corporate reform but also deep change in the society's culture. It appears from the paper that Russia has been taking significant steps toward reforming corporate governance. The Supreme Arbitrazh Court and the Federal Commission for the Securities Market have focused their attention on the need for corporate governance reform, which signifies a move in the 'right' direction.

### 3.1.23 South Africa

The first King Report (1994) was published in South Africa in order to formalize an ongoing process of corporate governance reform. It was a code of

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28 The King Report on Corporate Governance is a ground-breaking code of corporate governance in South Africa issued by the King Committee on Corporate Governance. Three reports were issued in 1994 (King I), 2002 (King II), and 2009 (King III). Compliance with the King Reports is a requirement for companies listed on the Johannesburg Stock Exchange. The
corporate practice and conduct that was based on a broad consensus of the South African business community. One of the most distinguishing aspects of South African corporate governance reform has been its focus on a more stakeholder-oriented approach.

The first King Report (1994) included a code of business ethics for companies and their stakeholders, representing one of the most forward-looking codes of corporate governance practice. However, 2002 saw the publication of an updated report, again taking the title the King Report (2002) from the chair of the Corporate Governance Committee, Mervyn E. King. The 2002 King Report continued in the same vein, by focusing on a stakeholder approach to corporate governance.

3.1.24 South Korea

From a corporate governance perspective, the case of South Korea is intriguing, as reform has been speedy and has engendered massive changes. Since the 1980s the Korean political environment has been liberalized. A recent President of the Republic of South Korea, Kim Dae Jung, has made efforts to attract foreign funds to Korea, to make Korean business more transparent, to improve corporate governance and to make Korea a globally competitive economy. He initiated a policy of reform called segyhewa, or 'globalization'. Until well after World War II, Korea was occupied by Japan. This meant that Korean business was influenced substantially by the Japanese structure of business. As in Japan, the corporate ownership structure has been characterized by founding family ownership concentration. The Korean chaebol, or conglomerate business groups, have arisen from small family-run companies and are now global players (e.g., Hyundai and LG). Until very recently, the corporate governance structure in Korea has kept its traditional 'insider' character. There has been little separation of ownership and control in Korean companies as the owners and managers have tended to be the same people at the highest level. Indeed, outdated hierarchical business strategies have been blamed in part for the way in which South Korea succumbed to the Asian crisis in 1997.

King Report on Corporate Governance has been cited as "the most effective summary of the best international practices in corporate governance".
However, in more recent times efforts have been made to create more equity financing for business and therefore to extend share ownership to a wider community of shareholders—institutional investors and the general public. The Government has forced companies to reduce debt in their financial structures and to take on equity finance to a greater extent. The proportion of institutional investor ownership in Korea is now about 35% - a lot lower than in the UK but a lot higher than it was before. Another important aspect of Korean corporate governance is the historic influence of factors such as the state, culture and the legal system. Until relatively recently, company law in Korea gave hardly any rights to minority shareholders (such as institutional investors). This is changing dramatically now. The Asian crisis in 1997 hit South Korea heavily and resulted in significant expropriation of minority shareholder wealth by majority shareholders in such companies as Samsung Electronics and SK Telecom. Such transfers of wealth highlighted a need for tightening of company law. The Government has had a substantial impact on company activities as state-owned banks have provided finance and the Government has instructed Korean companies on the strategic direction they wish them to take. Links with the state are now being lessened.

3.1.25 Taiwan

Taiwan's system of corporate governance fits neatly into the insider mould, with the majority of companies characterized by family control and concentrated share ownership. The legal system in Taiwan derives from the German mould and therefore places the Taiwanese system somewhere between the Anglo-Saxon type system and the French law-based systems of stock markets and corporate governance. However, the system of corporate governance in Taiwan is individualistic, with a board of directors accompanied by a group of supervisors, whose role is to provide an independent view to executive directors. On 15th October 2002, the Security and Futures Commission (SFC) of the Taiwan Stock Exchange (TSE) produced the first code of best practice on corporate governance, entitled Practical Guidance on Corporate Governance for Listed and OTC (Over the Counter) Companies.
3.1.26 Thailand

Thailand represents an insider-dominated system of corporate governance with an emerging stock market. Again, Thailand's economy was affected severely by the Asian crisis, and this has been attributed to corporate governance weaknesses, among other factors. Indeed, the whole crisis emanated from Thailand. In summer 1997 there was a devaluation of the Thai baht, following a collapse of the property market. Following the crisis there was, as in many of the other Asian economies, significant expropriation of minority shareholder wealth. In the case of Thailand, managers in the Bangkok Bank of Commerce transferred huge funds offshore to companies under their control. Since the Asian financial crisis, Thailand has been one of many countries to produce a code of best practice for the directors of listed companies (SET, 1998). Indeed, corporate governance weaknesses have been used partly as a scapegoat by the authorities in many countries since 1997.

3.1.27 United States

At the moment corporate governance is a hot topic in the USA. No one can think about corporate governance without turning immediately to the problems of Enron and WorldCom. If the USA has not got things right, being such an economically prosperous nation, then poorer countries stand no chance. Countries around the world have become introspective in their reaction to the problems in the USA, checking their own systems and corporate governance controls for similar Enron-type weaknesses. 'Enronitis' has spread across the world like a rampant virus. However, interest in US corporate governance is by no means new. The weight of literature and research in the corporate governance domain centres around the US system, or at least draws comparisons of countries' systems with that of the USA. Berle and Means' (1932) work was based on the US system of corporate governance. The first papers on agency theory focused on the US corporate governance system. Similarly, much of the path-breaking work on boards of directors and corporate performance, the impact of outside directors on performance and the impact of mergers and takeovers came initially from US.

academics. Although the UK and the USA have outsider, market-based systems of corporate governance, these systems display many differences. Shareholder activism is different between the two countries, with US investment institutions presenting shareholder resolutions to companies far more frequently. The notion of splitting the chairman and chief executive roles in the USA has not been viewed favourably, as board culture is extremely different from the UK. Another difference that we have already discussed is in remuneration. Executive remuneration in the USA has been traditionally far more excessive than in other countries, such as the UK, Monks and Minow\(^{30}\) (2001) provided a detailed insight into US corporate governance.

### 3.2 Convergence of Corporate Governance and Corporate Social Responsibility

There is an evolving interplay between corporate governance and corporate social responsibility.\(^{31}\) Both these mechanisms hold economic and legal features. These may be altered through socio-economic processes in which competition within the product market is the most powerful force.\(^{32}\) Corporate governance and corporate social responsibility are complementary and are closely linked with market forces. Their objectives are not concurrent; they may act as tools for attaining each other’s goals, though their setups as corporate frameworks are different. As corporate governance becomes increasingly driven by ethical norms and the need for accountability, and corporate social responsibility adapts to prevailing business practices, a potential convergence between them surfaces. Where there were once two separate sets of mechanisms, one dealing with "hard core" corporate decision-making and the other with "soft," people-friendly business strategies, but these days a more hybridized, synthesized body of laws and norms regulating corporate practices have developed. Those public policies which were traditionally imposed by formal regulatory bodies, such as workplace anti-discrimination and environmental protection boards, are now being

\(^{30}\) Supra n. 16.


collaboratively addressed through participation, negotiations, and dialogue between the public and private sectors. In fact, internal governance policies that emphasize social responsibility through transparency and coordination have been more successful in bringing about ethical corporate conduct than traditional command-and-control structures.

Corporate social responsibility operates in a free-form manner, whereas corporate governance issues operate within well defined and accepted structures. Corporate governance is an umbrella term. In its narrower sense, it describes the formal system of accountability of corporate directors to the owners of companies. In a broader sense, the concept includes the entire network of formal and informal relationships involving the corporate sector and the consequences of these relationships for society in general. These two senses are not concurrent; rather, they are complementary. Corporate governance has been described as the ways in which suppliers of finance to corporations assure themselves of obtaining a return on their investment. However, it could also implicate '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'. Taking these senses together, corporate governance is no longer merely about maximizing stock value; rather, it concerns the 'relationships among the many players involved (the stakeholders) and the goals for which the corporation is governed.'

In the marketplace, corporate governance is an old actor, whereas corporate social responsibility is comparatively new. It is worth noting that the

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33 Supra n.1 at 279.
35 Supra n. 2.
sophistication of consumers in the 1960s, the environmental movement of the 1970s and the increasing interest in the social impacts of business in the 1990s have all helped corporate social responsibility reach the heart of corporate governance. In almost every instance, these events did not specifically actuate corporate social responsibility initiatives; rather, these instances set the global scene for the intersection between corporate social responsibility and corporate governance. Several of these events have been important drivers of this intersection: the global social urge to include the previously excluded social costs of production and the hidden costs incurred by the environment as a result of business activities with the corporate balance sheet; the lack of confidence in the institutions of the market economy, and the demand for ensuring sustainable development. ‘Consumerism’ and ‘corporate scandals’ are the most important drivers underpinning this development. These two factors are, indeed, closely related to market competition, and hence, they act as strong drivers for corporate governance and corporate social responsibility to develop the required framework by which a company can demonstrate its responsibility to society through its performance. To corporate governance, this intersection largely contributes by reconciling the tension between corporate governance’s engagement with shareholder and stakeholder interest; it has become attuned to constituency concerns in corporate governance. To corporate social responsibility, this intersection establishes corporate social responsibility.

3.3 The Concept of Corporate Social Responsibility

Businesses worldwide are increasingly worried about the impact of their business activities on society. They also recognize that the world they live in presents a growing array of demands, pressures and risks that are not signaled through markets or the traditional political processes on which they have relied for a very long time. Business and industry have come into existence to promote social growth and social good. They draw resources from the society and add

38 Supra n.10.
39 Ibid.
40 Kakabadse, above n 1, 279; for a detailed study on this issue, see Maurice Thevenet, ‘Viewpoint: Global Responsibility and Individual Exemplarity’ (2003) 3(3) Corporate Governance 114.
values to generate wealth. Hence, society and business are interdependent and business must take full account of societal expectations. A stable social environment is a pre-requisite for business investment and industrial operations. So industry needs to facilitate such environment by taking care of the concerns of the society. Thus, many have implemented into their operation the so-called corporate social responsibility that aim to balance their operations with the concerns of internal and external stakeholders such as employees, customers, suppliers and business partners, labour unions, local communities, non-governmental organizations and governments. Over the couple of decades, the concept of corporate social responsibility (hereinafter also CSR) has received considerable research attention and a consensus is emerging that companies and organization have a social obligation to operate in ethically, socially and environmentally responsible ways. Companies now are realizing that successes are being measured not solely according to their financial performance, but also by their standards of ethics and transparency and by how they impact interact with and make a difference in the environment in which they operate. All the organizations have an impact on the society and the environment through their operation, products or services and through their interactions with key stakeholders groups including employee’s customer’s clients, suppliers, investors and the local community.  

Corporate Social Responsibility is the voluntary role and contribution on the part of the business community towards a better social and environmental development, which is beyond their investment to organizational development. The business organisations can be lead by large multinationals and for small, locally based businesses. While the actions on the part of business organisations here to be ethically bound to its stakeholders, who include customers, owners/investors, government, suppliers and competitors. Corporate Social Responsibility consists of a wide-range activities and programs for corporations that involve how to improve their social, environmental and local economic impact, their influence on society, social cohesion and human rights, and fair

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trade. Key areas of concern are environmental protection and the well being of employees, the community and civil society in general, both now and in the future. It refers to the comprehensive approach that a corporation takes to meet or exceed stakeholder expectations beyond measures of revenue, profit and legal obligation. The industrial expansion is a threat to the people living nearby and it invites protest from many like consumer, investors, activist groups, government regulators and other stakeholders. To develop a better rapport with the community in the implementation of the developmental activities the Non-Governmental organizations can play better role with the industry and community. They can help the industrial management in convincing the expansion program to the community and there by develop a proactive and social environmental and industrial development policy. Lower operating costs, Enhanced brand image and reputation, reduced regulatory oversight, Product safety and decreased liability, improved financial performance etc are the benefit to the organization. The benefit of Corporate Social Responsibility is not only for the community and organization but also for the employees.42

3.3.1 Corporate Governance beyond Profit Maximization

Business and Society have been inter-dependent since time immemorial. Though the dominant paradigm of business has been profit earning, the obsession with profit at any cost causes harm to both business and the society and ultimately the business flounders and fizzles out. Fortunately, corporate examples are there to vindicate that ultimately businesses that successfully blend their concern for profit with humane concern stay, survive and thrive. Hence, there is the need for humane business management.

Initially, the dominant objective of business was profit and of the wealth of the owners. But, business history is replete with instances that the mindless obsession with profit maximization at any cost, when carried to any extreme, can lead to failures like Enron, WorldCom, Parmalat, Satyam and Union Carbide etc. At the same time, these are also the business organization conducting business

following practices detrimental to the social well-being ultimately perish. On the other hand, business organizations demonstrating their social concern by blending their concern for profits with humane concerns like Johnson & Johnson, Maruti Limited, Reliance Industries Limited, and Tata Iron & Steel Company, etc. survive and thrive in the long-run. That is why there has been a dominant shift in business paradigm beyond profit maximization to social/humane concern. Now, social responsibility of business has become the buzzword of business terminology and also has been caught by storm in business discussions and debates.43

3.3.2 Defining Corporate Social Responsibility

Defining corporate social responsibility has not been and will not be an easy task, as there seems to be myriad number of definitions and a set of associated terms and ideas. Different people have described corporate social responsibility differently. The term corporate social responsibility is often used interchangeably with others, including corporate responsibility, corporate citizenship, business in society, social enterprise, sustainability, sustainable development, triple bottom line, societal value-added, strategic philanthropy, corporate ethics, and in some cases also corporate governance. There are also clear links between these terms and those relating to socially responsible investments, community investing, social capital, and collaborative governance. Some of the definitions are:

The International Labour Organization (ILO, 2007) described corporate social responsibility as “a way in which enterprises give consideration to the impact of their operations on society and affirm their principles and values both in their own internal methods and processes and in their interaction with other actors” and further specified CSR as “a voluntary, enterprise-driven initiative, which refers to activities that are considered to exceed compliance with law”. Problem Discussion and Objectives Corporate social responsibility (CSR) differs from place to place, industry to industry and over time. It is increasingly accepted that in order to define precisely what social responsibility means to a company, it needs to engage

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with its stakeholders and take into account their needs and aspirations when designing corporate social responsibility strategies and programmes. It is difficult to define corporate social responsibility precisely because it will always have a location-specific context. Corporate Social Responsibility could take the form of community relationship, volunteer assistance programmes, healthcare initiatives, special education / training programmes and scholarships, preservation of cultural heritage and beautification of cities. It is therefore vital to understand the corporate social responsibility initiatives and their priorities among companies, integration as a business strategy, review of initiative and its impact and priorities of areas for corporate social responsibility.  

**According to Phillip Kotler and Nancy Lee**, “corporate social responsibility is a commitment to improve community well being through discretionary business practices and contributions of corporate resources.”

**Mallen Baker** defined corporate social responsibility as “way companies manage the business processes to produce an overall positive impact on society.”

**According to Bowin H.R.**, “Social responsibility is the obligation of businessman to pursue those polices, to make those decisions, or to follow those lines of action which are desirable in terms of objectives and values of society.”

**According to World Business Council for Sustainable Development** defined Corporate Social Responsibility as “Corporate Social Responsibility is the continuing commitment by business to behave ethically and contribute to the economic development while improving the quality of life of workforce and their families as well as of the local community and the society at large.”

**According to CSR Asia**, it is a company’s commitment to operating in an economically, socially and environmentally sustainable manner whilst balancing the interests of diverse stakeholders while the international financial corporation terms it as the commitment of businesses to contribute to sustainable economic development by working with employees, their families, the local community and

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45 “Corporate Social Responsibility-Towards a Sustainable Future” A white paper by KPMG India.


society at large to improve their lives in ways that are good for business and for development. In the words of the European Commission, it is a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis.

**According to Milton Friedman** 48, it is the one and only one social responsibility of business-to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud. The Institute of Chartered Accountants in England & Wales describes the Corporate Responsibility as about ensuring that organizations manage their businesses to make a positive impact on society and the environment whilst maximizing value for their shareholders.

**The Australian Centre for Corporate Social Responsibility** 49 defines corporate social responsibility as the actions taken by an organization to minimize negative social and environmental impacts and leverage core competencies, products or services to create positive social and environmental impacts.

**Carlton** 50 defines it as Wealth creation without jeopardizing the environment and society today, or at any time in the future.

While the definitions of corporate social responsibility may differ, there is an emerging consensus on some common principles that underline corporate social responsibility which can be called the common denominators and they are discussed here:

**Corporate Social Responsibility is a business imperative:** Whether pursued as a voluntary corporate initiative or for legal compliance reasons, corporate social responsibility will achieve its intended objectives only if businesses truly believe that corporate social responsibility is beneficial to them.

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Corporate Social Responsibility is a link to sustainable development: Businesses feel that there is a need to integrate social, economic and environmental impact in their operation; and

Corporate Social Responsibility is a way to manage business: corporate social responsibility is not an optional add on to business, but it is about the way in which businesses are managed.

As a concept, corporate social responsibility has gained momentum recently in India, but as a way of life, Indians have practiced corporate social responsibility since times immemorial to affect social welfare and social well-being. Here is one such instance to quote from the first verse of ‘Ishavashya Upanishad’ that describes: “All that exists in this Universe is the abode of the Almighty. Therefore, enjoy the good things in life by sharing them with others. Do not covet the possessions of others.” This akin to the concept of Vasudhaiva Kutumbakam, in which the whole earth is to be treated as one’s family. Without going into semantics of its definition, corporate social responsibility can simply be defined as businessman’s decisions and actions taken for reasons at least partially beyond the firm’s direct economic or technical interest. The underlying justification behind corporate social responsibility is that business organizations operate within the society and earn profits by taking inputs from the society and then selling its outputs to the society itself. Therefore, just like a citizen, corporations also like corporate citizens have to reciprocate to the society for what it receives from the society. This implies that both business and society are interdependent. Both can survive only with cooperation with each other.

3.3.3 Core Elements of Corporate Social Responsibility

The corporate social responsibility Policy should normally cover following core elements:

3.3.3.1 Care for all Stakeholders

The companies should respect the interests of, and be responsive towards all stakeholders, including shareholders, employees, customers, suppliers, project affected people, society at large etc. and create value for all of them. They should develop mechanism to actively engage with all stakeholders, inform them of inherent risks and mitigate them where they occur.
3.3.3.2 Ethical functioning

Their governance systems should be underpinned by Ethics, Transparency and Accountability. They should not engage in business practices that are abusive, unfair, corrupt or anti-competitive.

3.3.3.3 Respect for Workers' Rights and Welfare

Companies should provide a workplace environment that is safe, hygienic and humane and which upholds the dignity of employees. They should provide all employees with access to training and development of necessary skills for career advancement, on an equal and non-discriminatory basis. They should uphold the freedom of association and the effective recognition of the right to collective bargaining of labour, have an effective grievance redressal system, should not employ child or forced labour and provide and maintain equality of opportunities without any discrimination on any grounds in recruitment and during employment.

3.3.3.4 Respect for Human Rights

Companies should respect human rights for all and avoid complicity with human rights abuses by them or by third party.

3.3.3.5 Respect for Environment

Companies should take measures to check and prevent pollution; recycle, manage and reduce waste, should manage natural resources in a sustainable manner and ensure optimal use of resources like land and water, should proactively respond to the challenges of climate change by adopting cleaner production methods, promoting efficient use of energy and environment friendly technologies.

3.3.3.6 Activities for Social and Inclusive Development

Depending upon their core competency and business interest, companies should undertake activities for economic and social development of communities and geographical areas, particularly in the vicinity of their operations. These could include education, skill building for livelihood of people, health, cultural and social welfare etc., particularly targeting at disadvantaged sections of society.
3.3.4 Challenges in Enforcement of Corporate Social Responsibility

3.3.4.1 Lack of Community Participation in corporate social responsibility activities

There is a lack of interest of the local community in participating and contributing to corporate social responsibility activities of companies. This is largely attributable to the fact that there exists little or no knowledge about corporate social responsibility within the local communities as no serious efforts have been made to spread awareness about corporate social responsibility and instill confidence in the local communities about such initiatives. The situation is further aggravated by a lack of communication between the company and the community at the grassroots.

3.3.4.2 Need to Build Local Capacities

There is a need for capacity building of the local non-governmental organizations as there is serious dearth of trained and efficient organizations that can effectively contribute to the ongoing corporate social responsibility activities initiated by companies. This seriously compromises scaling up of corporate social responsibility initiatives and subsequently limits the scope of such activities.

3.3.4.3 Issues of Transparency

Lack of transparency is one of the key issues brought forth by the survey. There is an expression by the companies that there exists lack of transparency on the part of the local implementing agencies as they do not make adequate efforts to disclose information on their programs, audit issues, impact assessment and utilization of funds. This reported lack of transparency negatively impacts the process of trust building between companies and local communities, which is a key to the success of any corporate social responsibility initiative at the local level.

3.3.4.4 Non-availability of Well Organized Non-governmental Organizations

It is also reported that there is non-availability of well organized nongovernmental organizations in remote and rural areas that can assess and identify real needs of the community and work along with companies to ensure successful implementation of corporate social responsibility activities. This also
builds the case for investing in local communities by way of building their capacities to undertake development projects at local levels.

3.3.4.5 Visibility Factor

The role of media in highlighting good cases of successful corporate social responsibility initiatives is welcomed as it spreads good stories and sensitizes the local population about various ongoing corporate social responsibility initiatives of companies. This apparent influence of gaining visibility and branding exercise often leads many nongovernmental organizations to involve themselves in event-based programs; in the process, they often miss out on meaningful grassroots interventions.

3.3.4.6 Narrow Perception towards corporate social responsibility initiatives

Non-governmental organizations and Government agencies usually possess a narrow outlook towards the corporate social responsibility initiatives of companies, often defining corporate social responsibility initiatives more donor-driven than local in approach. As a result, they find it hard to decide whether they should participate in such activities at all in medium and long run.

3.3.4.7 Non-availability of clear corporate social responsibility guidelines

There are no clear cut statutory guidelines or policy directives to give a definitive direction to corporate social responsibility initiatives of companies. It is found that the scale of corporate social responsibility initiatives of companies should depend upon their business size and profile. In other words, the bigger the company, the bigger is its corporate social responsibility program.

3.3.4.8 Lack of Consensus on Implementing Corporate Social Responsibility Issues

There is a lack of consensus amongst local agencies regarding corporate social responsibility projects. This lack of consensus often results in duplication of activities by corporate houses in areas of their intervention. This results in a competitive spirit between local implementing agencies rather than building collaborative approaches on issues. This factor limits company’s abilities to undertake impact assessment of their initiatives from time to time.
3.3.5 Alternative to Corporate Social Responsibility

All evidence suggests that profit maximization by a business organization does not necessarily confer maximum benefit on all parties and stakeholders. Instead, it results in inequitable consequences. At the same time, it would also be wrong to infer that profits are not important. In fact, they are crucial for survival of business. Only when a firm is profitable can continue in business and discharge its social responsibility also. But being profitable is not end itself. It is a means to other wholesome pursuits to be undertaken by the business.51

Profit with a purpose larger than one’s self-interest is the best guarantee for long-term peace, stability, and social cohesion, and is fundamentally necessary for corporations to pursue their business unhindered.52 As per the existing laws, ownership of modern business firms is conferred on people who invest their money in financial equity. Accordingly, they have been given exclusive rights to the profits earned. But, the fact remains that a modern firm has other types of equities as well in addition to financial equity. Investments in these other equities are made by a variety of stakeholders.

3.3.6 Corporate Social Responsibility in Other Countries

Corporate social responsibility activities in various countries are as follows:-

3.3.6.1 United States

The U.S. Department of State’s strong commitment to Corporate Social Responsibility (corporate social responsibility) is exemplified in a comprehensive approach to provide support and guidance on areas of responsible corporate conduct. (U.S. Department of State, July 17, 2013). Sector-specific corporate social responsibility initiatives center on responsible resource management, energy efficiency and climate change. The bureau of energy resources leads the U.S. department of state’s efforts to ensure that diplomatic relationships advance U.S. interests in access to secure reliable and ever-cleaner sources of energy. It

51 Id. at 1469.
promotes good governance and transparency in energy-sector management and access to commercially viable and environmentally sustainable energy for the 1.3 billion people currently without energy services. The U.S. department of state recognizes reducing corruption is inherently linked to corporate and social interests, particularly corporate social responsibility. the bureau of international narcotics and law enforcement affairs promotes anti-corruption internationally and supports corporate social responsibility by fostering clean business practices, engaging the business community in anti-corruption efforts and promoting a level playing field. The state department also partners with the private sector to tackle a number of significant global challenges, including the spread of HIV/ AIDS and youth unemployment.  

3.3.6.2 United Kingdom

The U.K. government’s corporate social responsibility policy is highly visible and very robust. The reason for this, in addition to the strong union tradition, is the pressure exerted on the government by numerous civil society campaigns. At the same time, the U.K. government views corporate social responsibility as a voluntary commitment on the part of the individual enterprise, which it encourages businesses to undertake using the argument of economic self-interest (“business case” for corporate social responsibility). In 2004, after 4 years of debate, the U.K. parliament enacted corporate responsibility regulations. The most important consequence of this legislation was that all U.K. companies became legally obliged to publish an annual sustainability report. Additionally, the law expanded the responsibilities of company directors so that they now also have a duty of care for society and the environment. According to the government sustainable development strategy, all ministers must compile a sustainable development action plan and report on their activities. The new deal for communities is an interdepartmental initiative that was launched in 1998.  

3.3.6.3 Canada

Although the Canadian government lacks formal policies promoting corporate social responsibility with incentives or disincentives, two government

54 Ibid.
agencies - industry Canada (IC) and foreign affairs and international trade Canada (DFAIT) - have successfully raised awareness in the private sector of corporate social responsibility and its advantages. Both IC and DFAIT seek to grow the Canadian economy and improve domestic conditions for investment and its competitiveness abroad. Within this mandate, both agencies promote corporate social responsibility principles and practices to Canadian businesses because “it makes companies more innovative, productive, and competitive.”

3.3.6.4 France

In early 2004, the French government established the forum des amis du pactemondial, a national network of business organizations whose members have signed the global compact and that are engaged in promoting and expanding corporate social responsibility practices. The forum now has more than 400 members and is the globe’s largest association of global compact companies. The network is sponsored by the business institute and by the organization businesses for the environment. With this, France has found a mechanism to introduce the global compact into national corporate social responsibility policies.

3.3.6.5 Germany

In Germany, the most important interdepartmental government advisory agency in the area of corporate social responsibility is the RNE- council for sustainable development. The council was created in 2001 by the federal government and assigned the task of publicly communicating the topic of sustainability while advising the government on sustainability-related topics. The coalition government formed after the 2005 elections has reaffirmed the council’s mandate. In August 2005, the federal government passed the sustainability guide, thereby both documenting implementation of the national sustainability strategy and continuing the 2002 strategy. One of the guide’s key areas is corporate social responsibility, defined by the RNE as an approach to sustainable development at the corporate level.

3.3.6.6 Mexico

In 2004, the Mexican Ministry of Economic created the “support Fund for Micro, Small and Medium Enterprises,” with a budget of 3 million pesos and the goal of promoting economic development based on competitiveness, productivity,
and sustainability. Part of the fund’s focus is to implement corporate social responsibility programs in small and medium enterprises (SMEs) as a way to promote socially responsible behaviour and sustainability. The government works with COMPITE, a Mexican non-profit organization, and provides subsidized corporate social responsibility consulting services for SMEs. Since the beginning of this government partnership, COMPITE has seen a sharp increase in the demand for corporate social responsibility consulting services and the organization is confident that Mexican SMEs that were not previously aware of corporate social responsibility concepts are now able to implement certain sustainable and responsible practices in their firms. In addition to helping SMEs incorporate corporate social responsibility initiatives into their strategies, this program has increased trust between the private sector, the federal and local governments, and the Mexican population.

3.3.6.7 Europe

The term “Corporate Social Responsibility” (CSR) has only taken recognizable shape in the European context recently. This has resulted from a number of factors, including the European Commission’s attempt to place corporate social responsibility on the European agenda. The EU green paper defines corporate social responsibility as “a concept whereby companies integrate social and environmental concerns in their business operation and their interaction with their stakeholders on a voluntary basis.” The EU’s conception of corporate social responsibility thus rests on the notion of free choice, and it derives from the ability to measure a company’s performance in terms of economic, social and ecological criteria. Corporate social responsibility is seen as a rational investment on the part of an individual company and, thus, part of its business strategy and not an additional, external activity.

Among European nations, France and Sweden lead the field with their concrete information requirements and their thorough going use of corporate social responsibility reports.
3.3.6.8 Indonesia

Recently government of Indonesia has released a government regulation on corporate social responsibility. There are different dimensions of corporate social responsibility programmes. There have been several human rights violations committed by multi-national enterprises throughout Indonesia. Corporate social responsibility is expected to be bridge to integrate and synthesize the two different interests of Society and corporation.

3.3.6.9 Corporate Social Responsibility in India

Corporate social responsibility 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. As a result, there is limited documentation on specific activities related to this concept. However, what was clearly evident that much of this had a national character encapsulated within it, whether it was endowing institutions to actively participating in India’s freedom movement, and embedded in the idea of trusteeship.

As some observers have pointed out, the practice of corporate social responsibility in India still remains within the philanthropic space, but has moved from institutional building (educational, research and cultural) to community development through various projects. Also, with global influences and with communities becoming more active and demanding, there appears to be a discernible trend, that while corporate social responsibility remains largely restricted to community development, it is getting more strategic in nature (that is, getting linked with business) than philanthropic, and a large number of companies are reporting the activities they are undertaking in this space in their official websites, annual reports, sustainability reports and even publishing corporate social responsibility reports.

The Companies Act, 2013 has introduced the idea of corporate social responsibility to the forefront and through its disclose-or-explain mandate, is promoting greater transparency and disclosure. Schedule VII of the Act, which lists out the corporate social responsibility activities, suggests communities to be the focal point. On the other hand, by discussing a company’s relationship to its
stakeholders and integrating corporate social responsibility into its core operations, the draft rules suggest that corporate social responsibility needs to go beyond communities and beyond the concept of philanthropy. It will be interesting to observe the ways in which this will translate into action at the ground level, and how the understanding of corporate social responsibility is set to undergo a change.

3.4 The Companies Act, 2013

In India, the concept of corporate social responsibility 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 corporate social responsibility provisions within the Act is applicable to companies with an annual turnover of 1,000 crores INR and more, or a net worth of 500 crores INR and more, or a net profit of five crores INR and more. The new rules, which will be applicable from the fiscal year 2014-15 onwards, also require companies to set-up a corporate social responsibility 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 corporate social responsibility activities. The ministry’s draft rules, that have been put up for public comment, define net profit as the profit before tax as per the books of accounts, excluding profits arising from branches outside India.

The Act lists out a set of activities eligible under corporate social responsibility. Companies may implement these activities taking into account the local conditions after seeking board approval. The indicative activities which can be undertaken by a company under corporate social responsibility have been specified under Schedule VII of the Act.

A format for the board report on corporate social responsibility has been provided which includes amongst others, activity-wise, reasons for spends under 2% of the average net profits of the previous three years and a responsibility statement that the corporate social responsibility policy, implementation and monitoring process is in compliance with the corporate social responsibility
objectives, in letter and in spirit. This has to be signed by either the CEO, or the MD or a director of the company.

According to the provisions of Companies Act, 2013, Every company having net worth of rupees five hundred crores or more, or turnover of rupees one thousand crores or more or a net profit of rupees five crores or more during any financial year shall constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director.55 The Board’s report under sub-section (3) of section 134 shall disclose the composition of the Corporate Social Responsibility Committee.56 The Corporate Social Responsibility Committee shall, (a) formulate and recommend to the Board, a Corporate Social Responsibility Policy which shall indicate the activities to be undertaken by the company as specified in Schedule VII; (b) recommend the amount of expenditure to be incurred on the activities referred to in clause (a); and (c) monitor the Corporate Social Responsibility Policy of the company from time to time.57

The Board of every company referred to in sub-section (1) shall after taking into account the recommendations made by the Corporate Social Responsibility Committee, approve the Corporate Social Responsibility Policy for the company and disclose contents of such Policy in its report and also place it on the company’s website, if any, in such manner as may be prescribed; and ensure that the activities as are included in Corporate Social Responsibility Policy of the company are undertaken by the company.58 The Board of every company referred to in sub-section (1), shall ensure that the company spends, 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, Provided that the company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for Corporate Social Responsibility activities, Provided further that if the company fails to spend such amount, the Board shall, in its report made under clause (o) of

55 Section 135 (1) of the Companies Act, 2013.
56 Section 135 (2) of the Companies Act, 2013.
57 Section 135 (3) of the Companies Act, 2013.
58 Section 135 (4) of the Companies Act, 2013.
sub-section (3) of section 134, specify the reasons for not spending the amount.\(^{59}\)

For the purposes of this section “average net profit” shall be calculated in accordance with the provisions of section 198.\(^{60}\)

Clause 135 of the Act lays down guidelines to be followed by companies while developing their corporate social responsibility programme. The corporate social responsibility committee will be responsible for preparing a detailed plan on corporate social responsibility activities, including the expenditure, the type of activities, roles and responsibilities of various stakeholders and a monitoring mechanism for such activities. The corporate social responsibility committee can also ensure that all the kinds of income accrued to the company by way of corporate social responsibility activities should be credited back to the community or corporate social responsibility corpus. The new Act requires that the board of the company shall, after taking into account the recommendations made by the corporate social responsibility committee, approve the corporate social responsibility policy for the company and disclose its contents in their report and also publish the details on the company’s official website, if any, in such manner as may be prescribed. If the company fails to spend the prescribed amount, the board, in its report, shall specify the reasons.

The concept of Corporate Social Responsibility has gained increased significance in recent years. The growing focus on corporate social responsibility has changed the attitude of businesses all over the world, and India is not an exception. The concept of corporate social responsibility is not new to India; historically speaking, social responsibility of companies is a well-established phenomenon in India, and the country has one of the world's richest traditions of corporate social responsibility. In its oldest forms, corporate social responsibility in India included the concept of corporate philanthropy and the Gandhian Trusteeship model. But the liberalization of the Indian economy in the 1990s led to a fundamental shift from the philanthropy-based model to a multi-stakeholder approach whereby companies are deemed responsible for all stakeholders, including financial stakeholders, employees and the community. The liberalization

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\(^{59}\) Section 135 (5) of the Companies Act, 2013.

\(^{60}\) Explanation to Section 135 of the Companies Act, 2013.
of the economy also led to the increased presence of large global corporations such as Microsoft, IBM, and others on Indian soil, which thereby exposed India to a highly developed regime of corporate social responsibility initiatives. Additionally, a strong desire to compete and succeed in the global economy drove Indian business enterprises to integrate corporate social responsibility into a coherent and sustainable business strategy. These enterprises, both public and private, have realized that their long-term success depends on the satisfaction of their stakeholders, and that ignoring them could jeopardize the company's future prospects in the community. Ever since their inception, corporate like the Tata Group, the Aditya Birla Group, and Indian Oil Corporation, to name a few have been involved in serving the community. Through donations and charity events, many other organizations have been doing their part for the society. The basic objective of corporate social responsibility in these days is to maximize the company's overall impact on the society and stakeholders. Corporate social responsibility policies, practices and programs are being comprehensively integrated by an increasing number of companies throughout their business operations and processes. A growing number of corporate feel that corporate social responsibility is not just another form of indirect expense but is important for protecting the goodwill and reputation, defending attacks and increasing business competitiveness. Companies have specialized corporate social responsibility teams that formulate policies, strategies and goals for their corporate social responsibility programs and set aside budgets to fund them. These programs are often determined by social philosophy which have clear objectives and are well defined and are aligned with the mainstream business. The programs are put into practice by the employees who are crucial to this process. Corporate social responsibility programs ranges from community development to development in education, environment and healthcare etc.

For example, a more comprehensive method of development is adopted by some corporations such as Bharat Petroleum Corporation Limited, Maruti Suzuki India Limited, and Hindustan Unilever Limited. Provision of improved medical and sanitation facilities, building and houses, and empowering the villagers and in process making them more self-reliant by providing vocational training and a
knowledge of business operations are the facilities that these corporations focus
on. On the other hand, the corporate social responsibility programs of corporations
like GlaxoSmithKline Pharmaceuticals’ focus on the health aspect of the
community. They set up health camps in tribal villages which offer medical
check-ups and treatment and undertake health awareness programs. Some of the
non-profit organizations which carry out health and education programs in
backward areas are to a certain extent funded by such corporations. Also
Corporate increasingly join hands with Non-governmental organizations (NGOs)
and use their expertise in devising programs which address wider social problems.
For example, a lot of work is being undertaken to rebuild the lives of the tsunami
affected victims. This is exclusively undertaken by SAP India in partnership with
Hope Foundation, an NGO that focuses mainly on bringing about improvement in
the lives of the poor and needy. The SAP Labs Center of HOPE in Bangalore was
started by this venture which looks after the food, clothing, shelter and medical
care of street children. Corporate social responsibility has gone through many
phases in India. The ability to make a significant difference in the society and
improve the overall quality of life has clearly been proven by the corporate. Not
one but all corporate should try and bring about a change in the current social
situation in India in order to have an effective and lasting solution to the social
woes. Partnerships between companies, NGOs and the government should be
facilitated so that a combination of their skills such as expertise, strategic thinking,
manpower and money to initiate extensive social change will put the socio-
economic development of India on a fast track.

The 21st century is characterized by unprecedented challenges and
opportunities, arising from globalization, the desire for inclusive development and
the imperatives of climate change. Indian business, which is today viewed
globally as a responsible component of the ascendancy of India, is poised now to
take on a leadership role in the challenges of our times. It is recognized the world
over that integrating social, environmental and ethical responsibilities into the
governance of businesses ensures their long term success, competitiveness and
sustainability. This approach also reaffirms the view that businesses are an
integral part of society, and have a critical and active role to play in the sustenance
and improvement of healthy ecosystems, in fostering social inclusiveness and equity, and in upholding the essentials of ethical practices and good governance. This also makes business sense as companies with effective corporate social responsibility, have image of socially responsible companies, achieve sustainable growth in their operations in the long run and their products and services are preferred by the customers. Indian entrepreneurs and business enterprises have a long tradition of working within the values that have defined our nation's character for millennia. India's ancient wisdom, which is still relevant today, inspires people to work for the larger objective of the well-being of all stakeholders. These sound and all-encompassing values are even more relevant in current times, as organizations grapple with the challenges of modern-day enterprise, the aspirations of stakeholders and of citizens eager to be active participants in economic growth and development.\textsuperscript{61} It is believed that the future of corporate social responsibility in India is bright, and that its importance will continue to grow even further given the increasing importance accorded to corporate social responsibility world-wide, and India's own realization that it needs corporate social responsibility to achieve long-term sustainability in the world economy.\textsuperscript{62}

\textsuperscript{61} India, Ministry of Corporate Affairs, Corporate Social Responsibility Voluntary Guidelines 2009.