To reiterate, ITC was incorporated in 1910 as a private limited company to manufacture cigarettes of certain British and American companies in India. In 1954, ITC became a public limited company by acquiring the manufacturing business of Tobacco Manufacturers (India) Ltd and Lithographic Printers (India) Ltd through its Indian Leaf Tobacco Development division. Though ITC clearly dominated the cigarette business, it soon realized that making only a single product, especially one that was considered injurious to health, could become a problem for long-term profitability and sustainability of the company. In addition, regular increases in excise duty on cigarettes started having a negative impact on the company’s profitability. To reduce its dependence on the cigarette and tobacco business, ITC started to diversify into new businesses. Initially, these diversification strategies have been supported by BAT, however, soon created a rift between the Indian management and Parent company. This chapter focusses on the agency problems in ITC Ltd during the early 90s and corporate governance transgressions thereafter. The chapter describes how ITC had initiated the governance reforms in light of these challenges, and how this has enabled the company not only to fix these problems but also develops a mechanism of internal controls for competitive advantage.

6.1 ITC Ltd: The Early Diversification

Evidently, the company diversified into new businesses to reduce its dependence on the cigarettes and tobacco business. It had set up a marine products export division in 1971. The company also reorganized itself and emerged as a new organization divided along product lines. In 1975, ILTD was made a division of ITC. In the same year it set up its first hotel in Madras. The company forayed into textile business with the promotion of Tribeni Handlooms in 1977. ITC also promoted Bhadrachalam Paperboards in 1977 to make papers and paperboards. In 1981, ITC diversified into the cement business and bought a 33 percent stake in India Cements from IDBI. This investment, however, did not generate the synergies that
ITC had visualized and, two years later the company divested its stake. In 1986, ITC established ITC Hotels, to which its three existing hotels were sold. In the same year, ITC entered the financial services business by setting up its subsidiary, ITC Classic Finance.

In the early 90s, the company has established ITC Agro Tech, based at Hyderabad to provide complete value chain services from supplying high quality hybrid seeds and providing meteorological data, to finally buying back the sunflower oil seed from the farmers' doorstep. Within a short period ITC Agro Tech Ltd has become the lifeline to the cultivators of the Kurnool area in Andhra Pradesh and achieved its target of becoming India's largest producer of branded edible oil in the private sector (Roy, 1992). In line with these developments, the company had set up a joint venture with Zeneca Seeds of UK to develop a superior range of hybrid seeds suitable to growing conditions in India. Both ITC and Zeneca Seeds had equal participation in the joint venture. This venture focussed on marketing 'Adarsh' brand of seeds to deliver improved crop yields to the Indian farmers.

On the wake of globalization, the ITC has also planned to explore opportunities in the high growth sectors like Power, Aviation and Foods. The company charted a systematic plan to diversify into aviation sector and considered to set up a new company for the purpose. The proposal to enter aviation sector was mooted by International Travel House, the travel management company of ITC and the already operational hotels and travel companies were to be synergised. Economic Times (1994) on Feb 16 stated that the company management had initiated discussions with leading airlines like Singapore Airlines; Malaysian Airlines; Aer Lingus; and two other leading South American airlines.

Thus, the company has transformed itself into a vibrant group. It has diversified interests in cigarettes, agri-business, Edible oil, paper and packaging, hotels. For the year ended March, 1992, ITC had sale of Rs. 2,968.1 crore and gross profit was Rs321.8 crore. ITC manufactured cigarettes (75 per cent of sales), agro-products (10.5 per cent) and paper and printing products (3.3 per cent). It also sold unmanufactured tobacco (5.4 per cent) and the hotel business accounted for 3.1 per cent of sales. Its cigarette factories were located in Calcutta, Bombay, Saharanpur and Munghyr, the paper plant at Tribeni in West Bengal and the printing and packing plants in Madras and Munghyr. ITC planned setting up a Rs100 crore, 600 tonnes per day mustard oil refinery in Rajasthan. ITC has opened offices in London, New York, Dubai and Singapore.
Despite successful diversification into non-core sectors, the company had faced some operational problems in 1993-94. After the 1994 stock market scam, ITC Classic Finance was left with a huge portfolio of illiquid assets. With ITC unable to bail out its subsidiary, the decision to sell ITC Classic became unavoidable. Similarly, Its International Business Division (IBD), posted operational losses of over Rs. 80 crore. The agri-business, paper and aqua products divisions had also posted losses. Similarly, its 3 investment companies, Sage, Elan and Pinnacle did not performed well due to depressed market conditions. In the wake of these developments, the parent company and other shareholders insisted ITC’s management to revisit their diversification strategy and suggest a road map for revival of loss making divisions.

ITC commissioned consultants McKinsey & Co., undertook a detailed study of the businesses of the company and made suitable recommendations. McKinsey advised ITC to disband diversification plans to power and aviation; withdraw from the agri-business where it was incurring losses and to concentrate on its core strengths. They had proposed ITC to disband its International Business Division (IBD) as part of its restructuring. The McKinsey’s report concluded that the mainstay business of the IBD would be shifted to other group companies- ITC Agro Tech Ltd, ITC Minota Aquatech Ltd and ITC Global Holdings Pte. They opined that the diversified business of IBD would be divided among subsidiaries and group companies on the basis of specialisations. While the agri exports business was to be handed over to ITC Agro Tech Ltd, the commodities trading activities was proposed to be handed over to ITC Global Holdings and the aqua farms business was to be handed over to ITC Minota.

Alongside, the liberalisation reforms have made BAT to plan an increase of its equity in ITC from 31 percent to majority ownership of 51 percent. The BAT wanted a majority control in ITC through a preferential allotment and divestment of ITC’s business outside tobacco and financial services. But unlike other Indian companies with a foreign parentage (Colgate, Procter and Gamble, Castrol) who have so readily welcomed the renewed interest and infusion of investment from overseas, for ITC, BAT's intent posed an existential dilemma. Ever since ITC has been both Indian managed and Indian-led, its Independent-minded management has, over the years, successfully transformed ITC’s profile from a 'tobacco and cigarettes company' to a widely diversified enterprise. ITC has diversified into areas such as hotels, edible oils, paper, printing and packaging. The Financial Institutions under the government of India also supported the ITC’s management and opposed the move from BAT.
This had left BAT Industries with no option than halt its desire to increase its equity from 31 percent to 51 percent. Thus in the face of fierce opposition from ITC and others, the BAT had agreed to respect ITC’s aspirations to become a multinational corporation (Business World, 1994). Nevertheless, most of new businesses of ITC were alien businesses for the 25 billion pound sterling BAT group which is world's second largest cigarette maker.

6.2 The Emergence of Governance Problems

During the 1980s and 1990s, ITC’s image and management approach was threatened because of various allegations of unethical practices of the company. These included excise violation, FERA violation, insider trading and mismanagement of funds. A tussle between BAT and ITC over management control seemed to have worsened matters further.

6.2.1 Excise Violations

Till 1983, excise on cigarettes was based on the price at which they were sold. Many cigarette companies had resorted to under-invoicing to reduce the excise duty payable. Rumors floated that distributors returned a part of the premium earned in the market to the manufacturer. The excise department initially accused ITC of receiving such ‘flow-backs’, however, later dropped these charges for lack of evidence. The 1983 budget announced that excise would be charged on the basis of the printed price. When this system was also abused, the government introduced in 1988 a new system where excise was charged on the basis of the cigarette length.

A Business India article (8-22 May, 1995) reported that top ITC managers had been involved in various unethical dealings. One common practice involved declaring large stocks of good cigarettes to be damaged and therefore, ‘deemed for destruction’ (classified internally as DD). ITC would then claim a refund of excise duty paid for these cigarettes. Distributors sold these cigarettes to the trade and passed on a part of the realization to the executives.

6.2.2 The BAT and ITC Spat:

ITC had always received BAT’s full support since its first Indian chairman - Ajeet N Haksar’s time. ITC’s diversification into non-tobacco businesses had received BAT’s approval, even though these businesses were alien to BAT. With the change of leadership, as J.N Sapru took over Chairmanship, the relations with BAT have further improved. The Indian
management’s good equations with BAT had resulted in the parent company’s wholehearted acceptance of diversification agenda in the early 1980s.

Initially, The ITC’s Indian management had always kept BAT informed of all major strategic decisions. But, the changing management style during the times of Kishan L Chugh, however, has taken a stand not to involve parent company executives in the operational matters. Chugh however chose not to inform BAT about many strategic decisions; one such was ITC’s tie-up with Peregrine, global financial services major in 1993. BAT, which was also a global player in financial services, viewed this move with concern. Though, the venture did not work out eventually, Chugh’s relations with BAT soured. In September 1993, ITC launched its $91.8 mn GDR issue, managed by Merrill Lynch and Peregrine. While the issue had in principle been cleared by BAT, it took place with no prior intimation to BAT.

According to many insiders, the ITC’s management under the leadership of Chugh’s was radically different from that of earlier Indian chairman. Both Haskar and Sapru believed in decentralized decision-making and encouraged debates and disagreements. K.L Chugh, on the other hand, was a hands-on executive and tried to keep decision making centralized. There were instances wherein some of Chugh’s trusted lieutenants had been encouraged to bypass their bosses and report directly to the chairman.

Gradually, Chugh’s autocratic style began to create problems within the organization. By 1995, ITC’s main executive body, the committee of directors had virtually become defunct and non-functional. Notwithstanding, these problems, the chairman and his associates continued to consolidate their position helped by the company’s strong financial performance.

In a board meeting in November 1994, BAT proposed a nomination committee to screen future board appointments. The Indian management under Chugh saw ulterior motives behind this move. In a February 1995 board meeting, the difference between Chugh and BAT deepened when the Indian chairman wanted to include his associates in the nominations committee while BAT strongly opposed the move.

The main conflict between BAT and Indian management of ITC seemed to be over BAT’s intention of acquiring a 51 percent stake in ITC. The ITC’s management explained that they had opposed BAT’s move only because they did not want ITC to be reduced to being just a tobacco company. In a shrewd move, the management played ‘swadeshi’ card posing as an
Indian professional management making valiant efforts to ward off an ‘MNC marauder’. In the process the incumbent management team of ITC had received favorable publicity in the media.

All of a sudden in March 1995, a press release issued by the UK-based parent company of ITC, British American Tobacco (BAT) shocked the Indian corporate world. Expressing a lack of confidence in K. L. Chugh, the chairman of its Indian subsidiary, ITC, the press release demanded his resignation. The incident took place soon after Chugh had accused BAT of trying to forcibly increase its stake in ITC to gain majority and that BAT was not in favour of ITC’s diversification into the power generation business.

Subsequently, Chugh was called for a meeting with BAT management team in London. During the meeting, BAT made clear its intentions to increase its equity stake in ITC. It also demanded Chugh’s resignation. Chugh asked for a week’s time to put in his resignation and returned to Delhi. Instead of complying with BAT’s wishes, Chugh held a meeting with his close associates. Thereafter, Chugh presented his case before the Indian media. The Indian management led by Chugh advocated that BAT does not want to see ITC as a multinational competing in the global marketplace, and wants to confine ITC’s activities to just tobacco and finance. These views have been backed by the media and Indian financial institutions too had come to the rescue of ITC’s management, and condemned the BAT’s approach to acquiring control of ITC.

BAT seemed to have been completely taken aback by these actions, but quickly realized that it would not be able to put down Chugh easily. Consequently, in May 1995, BAT chairman met Chugh to assure him that it did not have any takeover plans and that it would support ITC’s diversification efforts. BAT had apparently reconciled to the fact that it cannot secure the Indian chairman’s resignation as he enjoyed the support of financial institution nominees on the board and executive directors.

However, in June 1995, BAT once again openly accused Indian management team of financial irregularities. BAT’s CEO even demanded ITC chairmen’s resignation. BAT alarmed at the manner in which Chugh had apparently ‘departed from the standards of professional management’. The BAT claimed that a special audit committee, set up by the board to investigate BAT's charges of financial bungling by ITC, had proved the irregularities by ITC and its subsidiary, ITC Global, in Singapore. The audit report also highlighted many incidents of mismanagement. These include ITC showing an income of Rs25 crore from the
sales of Sundrop brand of sunflower oil to a subsidiary company, ITC Agro Tech Ltd, although the brand was not registered with ITC. The company's international business division (IBD) understated losses in its aquafood export operations. The losses were Rs32 crore and not Rs.13 crore as stated. ITC overstated export earnings in 1992-93 by the book entry of income from transactions in 1993-94. The accounting policy of IBD and ITC Global were inconsistent. The audit report showed the nexus between ITC Global, IBD and the EST group of New York. Undue preference was given to EST by way of credit, cash and trade advances by IBD, so that EST can keep up its financial commitments to ITC Global.

Alongside, BAT also emphasized that its main concern was not acquiring a majority stake in ITC, but restoring professionalism to ITC’s management. Guruswamy Mohan (1995) described that BAT’s frontal attack came on the eve of the EGM convened on 24th March 1995 to approve ITC’s diversification into the power sector (deemed to be Chugh’s pet project). The venture implied a considerable financial commitment from BAT. The parent company categorically stated that it would approve the diversification only if Chugh resigned.

Finally, in September 1996, Chugh decided to resign citing irresolvable differences of opinion with BAT. The move came after Chugh had been under three-day question hour by a special audit committee probing FERA violations and the loss making export transactions. The committee gave Chugh a clean chit and BAT did not press further. Chugh reported to have been given a handsome severance package as well. The media considered the peace making moves as efforts by the two sides to avoid having to wash dirty linen in public.

Though BAT has succeeded in putting down Mr Chugh and his team, but it did not have the total freedom to nominate the successor because of the financial institutions which held 38 percent stake in the company. The ITC’s nominations committee has been entrusted to decide on the future management structure and the chairman. The committee consisted of two BAT representatives and five institutional nominees.

The Indian Financial Institutions had decided to look for suitable person to fill the vacancy within the country. BAT had suggested to split the chairman post of chief executive officer into a non-executive chairman and a separate managing director. But the Indian Financial Institutions had disagreed with BAT's proposal to split up the chairman's post in ITC.
BAT Industries of the UK was likely to favour a complete reorganization of the ITC Board which was to include transfer of some of the Indian directors overseas. It proposed a plan in the final round of meetings with financial institutions that the existing members of the ITC Board lack requisite experience to head ITC Limited.

In midst of all these developments, the tobacco division of ITC Ltd had recorded a 63 percent market share in volume in 1995-96 (60 percent in 1994-95). This performance of ITC has silenced the representatives of BAT who had proposed to appoint their representative as chairman of ITC. The Indian financial institutions had upheld the performance of the company in recommending an Indian candidate for the post, so as to not disturb the continuity.

At last, Mr Yogesh Chander Deveshwar has been appointed as the chairman and chief executive officer of the company. The appointment has been a critical victory for the Indian financial institutions (FIs) who collectively held 38 percent stake in ITC. However, the BAT did not support the choice and had threatened to withdraw active support to ITC's activities. BAT has suggested bifurcation of the ITC board with the chairman taking charge of the overall policy matters of ITC and the vice chairman to look after the day-to-day operations. This was opposed by the financial institutions. The Indian chairman’s choice was strongly supported by the board with two nominees from BAT dissenting.

Thus the management of the ITC Ltd, its largest shareholder, BAT Industries (31.5 percent stake), and the Indian financial institutions had made a temporary reconciliation. They decided to work together as a team to address the various issues which dogged the company in recent times. The BAT, which was harping on gaining management control in the company, had decided to adopt a wait and watch policy, though it was being rumoured during the first half of 1996 that foreign institutional investors (FIIs) had acquired 3.5 percent of ITC's equity on behalf of BAT.

6.2.3 ITC-FERA Violation Story

A majority of ITC’s legal troubles could be traced back to its association with the US based entrepreneurs - Suresh Chitalia and Devang Chitalia (Chitalias). The Chitalias were ITC’s trading partners in its international trading business and were also directors of ITC International, the international trading subsidiary of ITC. In 1989, ITC started the ‘Bukhara’ chain of restaurants in the US, jointly with its subsidiary ITC International and some Non-
Resident Indian (NRI) doctors. Though the venture ran into huge losses, ITC decided to make good the losses and honour its commitment of providing a 25% return on the investments to the NRI doctors. ITC sought Chitalias’ help in this regard.

Accordingly, the Chitalias bought the Bukhara venture in 1990 for around $1 million. Investors were paid off through the Chitalias New-Jersey based company, ETS Fibers, which supplied waste paper to ITC Bhadrachalam Limited. To compensate the Chitalias, the Indian Leaf Tobacco Division (ILTD) of ITC transferred $4 million to a Swiss bank account, from where the money was transferred to Lokman Establishments, another Chitalia company in Liechtenstein. Lokman Establishments made the payment to the Chitalias. This marked the beginning of a series of transgressions that eventually resulted in the company being charged for contravention of FERA regulations.

During the 1980s, ITC had emerged as one of the largest exporters in India and had received accolades from the government. This was a strategic move on ITC’s part to portray itself as a good corporate citizen’ earning substantial foreign exchange for the country. In the early 1990s, ITC started exporting rice to West Asia. When the Gulf war began, ITC was forced to withdraw rice exports to Iraq, which resulted in large quantities of rice lying waste in the warehouses. ITC tried to export this rice to Sri Lanka, which however turned out to be a damp squib because the rice was beginning to rot already. There were discussions in the Colombo parliament as to the quality of the rotting rice. This forced ITC to import the rice back to India, which was not allowed under FERA.

There were a host of other such dubious transactions, especially in ITC’s various export deals in the Asian markets. The company, following the Bukhara deal, had set up various front companies (shell or bogus companies) with the help of the Chitalias. Some of the front companies were Hup Hoon Traders Pvt. Ltd., EST Fibers, Sunny Trading, Fortune Tobacco Ltd., Cyprus, Vaam Impex & Warehousing, RS Commodities, Sunny Snack Foods and Lokman Establishment, the one involved in the Bukhara deal. These front companies were for export transactions. It was reported that ITC artificially hiked its profits by over-invoicing imports and later transferring the excess funds as export proceeds into India. Critics pointed out that ITC did all this to portray itself as the largest exporter in the country.

In 1991, ITC asked all its overseas buyers to route their orders through the Chitalias. The Chitalias over-invoiced the export orders, which meant they paid ITC more than what they received from overseas buyers. For instance, in an export deal to Sri Lanka, ITC claimed to
have sold rice at $350 per ton – but according to ED, the rice was actually sold for just $175 per ton. ITC compensated the difference in amount to the Chitalias through various means including under invoicing other exports to them, direct payments to Chitalia companies and through ITC Global Holdings Pte Ltd. (ITC Global), a Singapore-based subsidiary of ITC. ITC Global was involved in a number majority of the money laundering deals between ITC and Chitalias.

However, by 1995, ITC Global was on the verge of bankruptcy because of all its cash payments to the Chitalias. It registered a loss of US $16.34 million for the financial year 1995-96, as against a profit of US $1.7 million in 1994-95. The loss was reportedly due to the attrition in trade margins, slow moving stock and bad debts in respect of which provisions had to be made.

It was also reported that ITC Global incurred a loss of $20 million on rice purchased from the Agricultural Products Export Development Authority (APEDA), which was underwritten by the Chitalias. By the time this consignment was exported to S Armagulam Brothers in Sri Lanka through Vaam Impex, another ITC front company, there was an acute fall in international rice prices. The consignee (S Armagulam Brothers) rejected the consignment because of the delay in dispatch. Following this, ITC bought back that rice and exported it to Dubai, which was against FERA regulations.

This resulted in huge outstanding debts to the Chitalias, following which they turned against ITC and approached BAT complaining of the debts and other financial irregularities at ITC in late 1995. BAT, which was not on good terms with the ITC’s Indian management, reportedly took this as an opportunity to tarnish the reputation of Chugh, who was the then chairman and compel him to resign. As mentioned earlier, BAT appointed a renowned audit firm Lovelock and Lewes to probe into the irregularities at ITC. Though the audit committee confirmed the charges of financial irregularities at ITC during the early 1990s and the role of the Chitalias in the trading losses and misappropriations at ITC during the year 1995-96, yet it cleared Chugh of all charges because as he agreed to resign. However according to industry sources, though the Chitalias were on good terms with ITC, it was BAT, which instigated the Chitalias to implicate the top management of ITC. BAT reportedly wanted to ‘step in as a savior’ and take control of ITC with the active support of the FI nominees on the board, which had supported ITC before charges of unethical practices surfaced.
Meanwhile, the Chitalias filed a lawsuit against ITC in US courts to recover their dues. They alleged that ITC used them to float front companies in foreign countries in order to route its exports through them. They also alleged ITC of various wrongdoings in the Bukhara deal. These events attracted Enforcement Directorate of India’s (ED) attention to the developments at ITC and it began probing into the company’s operations. ED began collecting documents to prove that ITC had violated various FERA norms to pay the NRI Doctors.

6.2.4 FERA Violations

The ED found out that around $ 83 million was transferred into India as per ITC’s instructions on the basis of the accounts maintained by the Chitalia group of companies. According to the ED, the ITC management gave daily instructions to manipulate the invoices related to exports in order to post artificial profits in its books. A sum of $ 6.5 million was transferred from ITC Global to the Chitalias’ companies and the same was remitted to ITC at a later date. Another instance cited of money laundering by ITC was regarding the over-invoicing of machinery imported by ITC Bhadrachalam Paperboards Ltd., from Italy. The difference in amount was retained abroad and then passed to the Chitalias, which was eventually remitted to ITC.

The ED issued charge sheets to a few top executives of ITC and raided on nearly 40 ITC offices including the premises of its top executives in Kolkata, Delhi, Hyderabad, Guntur, Chennai and Mumbai (Financial Express, 1996). The charge sheets accused ITC and its functionaries of FERA violations that included over-invoicing and providing cash to the Chitalias for acquiring and retaining funds abroad, for bringing funds into India in a manner not conforming to the prescribed norms, for not realizing outstanding export proceeds and for acknowledging debt abroad.

6.2.5 Overview of FERA Violations by ITC

- ILTD transferred $4 million to a Swiss bank account. The amount was later transferred to Lokman Establishment, which in turn transferred the amount to a Chitalia company in the US.
- ITC also made payments to non-resident shareholders in the case of certain settlements without The permission of the RBI. This was against Sections 8(1) and 9(1)(a) of FERA;
- ITC under-invoiced exports to the tune of $1.35 million, thereby violating the provisions of Sections 16(1)(b) and 18(2);
- ITC transferred funds in an unauthorized manner, to the tune of $0.5 million outside India by suppressing facts with regard to a tobacco deal. This was in contravention of Section a (1) read with Section 48;
- ITC acquired $0.2 million through counter trade premium amounting to between 3 and 4 per cent on a total business of 1.30 billion, contravening Section 8(1);
- The company had debts to the tune of 25 million due to over-invoicing in coffee and cashew exports during 1992-93 to the Chitalias, contravening Section 9(1)(c) read with Section 26(6);
- G. K. P. Reddi, R. K. Kutty, Dr. E. Ravindranath and M. B. Rao also violated the provisions of Sections 8(1), 9(1)(a), 9(1)(c), 16(b), 18(2) and 26(6) read with Section 68 of FERA.

The ED also investigated the use of funds retained abroad for personal use by ITC executives. Though the ED had documentary proof to indicate illegal transfer of funds by top ITC executives, nothing was reported in the media. The top executives were soon arrested. In addition, the ED questioned many executives including Mr. Ashutosh Garg, former chief of ITC Global, Mr. S. Khattar, the then chief of ITC Global, the Chitalias, officials at BAT and FI nominees on ITC board.

Meanwhile, the Chitalias and ITC continued their court battles against each other in the US and Singapore. ITC stated that the Chitalias acted as traders for ITC’s commodities including rice, coffee, soyabees and shrimp. ITC accused the Chitalias of non-payment for 43 contracts executed in 1994. ITC sued the Chitalias seeking $12.19 million in damages that included the unpaid amount for the executed contracts plus interest and other relief. Following this, the Chitalias filed a counter-claim for $55 million, accusing ITC of commission defaults (trading commission not paid) and defamation.

In August 1996, the Chitalias indicated to the Government of India and the ED their willingness to turn approvers in the FERA violation case against ITC, if they were given immunity from prosecution in India. The government granted the Chitalias, immunity under section 360 of the Indian Criminal Procedure Act, following which the Chitalias were reported to have provided concrete proof of large scale over-invoicing by ITC mainly in the export of rice, coffee and cashew nuts. In another major development, a few directors and
senior executives of ITC turned approvers in the FERA violation case against the company in November 1996.

The same month, the High Court of Singapore appointed judicial managers to take over the management of ITC Global. They informed ITC that ITC Global owed approximately US $49 million to creditors and sought ITC’s financial support to settle the accounts. Though ITC did not accept any legal liability to support ITC Global, it offered financial assistance upto $26 million, subject to the consent and approval of both the Singapore and Indian governments.

In December 1996, most of the arrested executives including Chugh, Sapru, R. Ranganathan, R K Kutty, E Ravindranathan, and K.P. Reddi were granted bail. ITC sources commented that BAT instigated the Chitalias to sue and implicate its executives. BAT was accused of trying to take over the company with the help of the financial institutions (FIs), who were previously on ITC’s side. In November 1996, BAT nominees on the ITC board admitted that BAT was aware of the financial irregularities and FERA violations in ITC. However, BAT authorities feigned ignorance about their knowledge of the ITC dealings and charges of international instigation against ITC.

Thus ITC landed in a mess due to gross mismanagement at the corporate level. Many agreed that poor corporate governance practices at ITC were principally responsible for its problems. They remarked that nominees of the FI and BAT never took an active part in the company’s affairs and remained silent speculators, giving the ITC nominees a free hand. It is nevertheless difficult to believe that FIs and BAT nominees had no idea of these financial wrongdoings and unfair practices. Apparently, the board members of ITC, did not ask for more disclosures and information. Few industry critics also commented that ITC followed a highly centralized management structure where power vested in the hands of a few top executives.

6.3 The Aftermath – Setting Things Right

ITC Ltd, the tobacco major with sales of Rs. 5000 crore, had descended from its pedestal as one of the best managed corporates in India, with the arrest of its top executives for Foreign Exchange Regulations Act (FERA) violations. The dramatic turn of events from 1996 to 98 had worsened the reputation of ITC. Alarmed by the growing criticism of its corporate governance practices and the legal problems, ITC took some drastic steps in its board
meeting held on November 15, 1996. ITC inducted three independent, non-executive directors on the Board. ITC also suspended the powers of the Committee of Directors and appointed an interim management committee. This committee was headed by the Chairman and included chief executives of the main businesses to run the day-to-day affairs of the company until the company had a new corporate governance structure in place.

Surprisingly, BAT had worked with financial institutions (FIs) in revamping the ITC board. The government was also unhappy with the role of the Indian management at ITC. The BAT had put forward a proposal to form a new committee with senior ITC executives at vice presidential levels to handle the daily affairs of the company. ITC also appointed a chief vigilance officer (CVO) for the ITC group, who reported independently to the board. ITC restructured its management and corporate governance practices in early 1997. The new management structure comprised three tiers- the Board of Directors (BOD), the Core Management Committee (CMC) and the Divisional Management Committee (DMC), which were responsible for strategic supervision, strategic management, and executive management in the company respectively.

However, the company’s troubles seemed to be far from over. In the last three months of 1997, ITC’s share price underwent dramatic ups and downs. In October, it reached a high of Rs 652.90. Later, it fell by more than Rs 100 to Rs 525. It increased against the next month to Rs 601.50 after reaching a low of Rs 488.30. This was repeated in December, when it zoomed to Rs 648 and then touched a low of Rs 526. ITC’s half yearly results were announced on November 21, 1997. On November 20, the share price had increased from Rs 489.70 to Rs 505.40 on NSE and from Rs 492.25 to Rs 506 on BSE. A whopping 287 lakh shares changed hands on NSE while BSE reported 111 lakh share trades, the highest ever in the stock’s history.

In the second week of November 1997, the Kerala High Court ordered CBI to investigate a fraudulent transaction involving ITC shares on a petition filed by a Kochi based investor. According to the investor, when the market had reopened for trading at 1200 hrs on Thursday, November 6, it was found that a transaction for 100 ITC shares had been entered on NSE at the rate of Rs 615 per share where the market price was only Rs 558. By recording the transaction at the rate of Rs 615, interested parties had apparently attempted to ward off the selling pressure on the shares.
Following these incidents, The Securities and Exchange Board of India (SEBI), decided to conduct detailed investigations. Though these investigations failed to produce concrete evidence of ITC’s involvement in insider trading, speculations about ITC’s hand in the volatile share price movements remained alive.

In the post-FERA violation developments, the ITC decided to retain interests in tobacco, hospitality and paper. ITC either sold off or gave up the controlling stake in several non-core businesses. It had shelved off power sector diversification agenda. In December 1997, ITC Classic was merged with ICICI at a swap ratio of 15:1. ITC agreed to sanction Rs 350 crore as interest free advance to ITC Classic and buy its assets. ITC also settled all of ITC Classic bad debts. Many of ITC Classic’s employees were absorbed by ICICI. In 1999, ITC consolidated most of its investment holdings into a single company Russel Credit. Two subsidiaries, Summit Investments and Sage Investments were merged with Russel Credit in February 1999. In May 1999, ITC sold off ITC Classic’s home finance business to the K K Birla group for Rs 10 crore.

Likewise, ITC divested its 51 percent stake in ITC Agrotech to ConAgra of the US, the world’s fourth largest company in the food business. ITC Zeneca, the seed manufacturing company and ITC Palm Tech were also merged with the new agri-business entity. Tribeni Tissues (which manufactured newsprint, bond papers, carbon and thermal paper) was merged with ITC.

Notably, the ITC’s board had adopted a three tier governance strategy and restricted the total number of executive directors on the board to a maximum of five. The strategy also envisaged the management of ITC's businesses by the respective chief executive officers while the overall supervision of ITC as a whole was to be taken care by the executive directors. Through this three-tiered interlinked governance process, ITC claimed to have struck a balance between the need for operational freedom, supervision, control and checks and balances. Each executive director was responsible for a group of businesses/corporate functions, apart from strategic management and overall supervision of the company.

In 1999, the company had adopted formal corporate governance framework based on international norms of transparency and good governance. The governance policy equally provided freedom of executive management to respond to the dynamics of a fast changing business environment whilst adhering to the internal controls and ethical code of conduct. The following section deals with the governance framework at length.
6.4 Definition and Purpose of Corporate Governance:

ITC defines Corporate Governance as a systemic process by which companies are directed and controlled to enhance their wealth generating capacity. Since large corporations employ vast quantum of societal resources, they believe that the governance process should ensure that these companies are managed in a manner that meets stakeholders aspirations and societal expectations.

6.4.1 Core Principles

ITC's Corporate Governance initiative is based on two core principles. These are:

(i) Management must have the executive freedom to drive the enterprise forward without undue restraints; and

(ii) This freedom of management should be exercised within a framework of effective accountability.

ITC believes that any meaningful policy on Corporate Governance must provide empowerment to the executive management of the Company, and simultaneously create a mechanism of checks and balances which ensures that the decision making powers vested in the executive management is not only misused, but is used with care and responsibility to meet stakeholder aspirations and societal expectations.

6.4.2 Cornerstones of Corporate Governance Policy

From the above definition and core principles of Corporate Governance emerge the cornerstones of ITC's governance philosophy, namely trusteeship, transparency, empowerment and accountability, control and ethical corporate citizenship. ITC believes that the practice of each of these leads to the creation of the right corporate culture in which the company is managed in a manner that fulfills the purpose of Corporate Governance.

Trusteeship

ITC believes that large corporations like itself have both a social and economic purpose. They represent a coalition of interests, namely those of the shareholders, other providers of capital, business associates and employees. This belief therefore casts a responsibility of trusteeship on the Company's Board of Directors. They are to act as trustees to protect and enhance shareholder value, as well as to ensure that the Company fulfills its obligations and
responsibilities to its other stakeholders. Inherent in the concept of trusteeship is the responsibility to ensure equity, namely, that the rights of all shareholders, large or small, are protected.

**Transparency**

ITC believes that transparency means explaining Company's policies and actions to those to whom it has responsibilities. Therefore transparency must lead to maximum appropriate disclosures without jeopardising the Company's strategic interests. Internally, transparency means openness in Company's relationship with its employees, as well as the conduct of its business in a manner that will bear scrutiny. We believe transparency enhances accountability.

**Empowerment and Accountability**

Empowerment is an essential concomitant of ITC's first core principle of governance that management must have the freedom to drive the enterprise forward. ITC believes that empowerment is a process of actualising the potential of its employees. Empowerment unleashes creativity and innovation throughout the organisation by truly vesting decision-making powers at the most appropriate levels in the organisational hierarchy.

ITC believes that the Board of Directors are accountable to the shareholders, and the management is accountable to the Board of Directors. They believed that empowerment, combined with accountability, provide an impetus to performance and improve effectiveness, thereby enhancing shareholder value.

**Control**

ITC believes that control is a necessary concomitant of its second core principle of governance that the freedom of management should be exercised within a framework of appropriate checks and balances. Control should prevent misuse of power, facilitate timely management response to change, and ensure that business risks are pre-emptively and effectively managed.

**Ethical Corporate Citizenship**

ITC believes that corporations like itself have a responsibility to set exemplary standards of ethical behaviour, both internally within the organisation, as well as in their external
relationships. They believe that unethical behaviour corrupts organizational culture and undermines stakeholder value.

6.4.3 The Governance Structure

Flowing from the philosophy and core principles, Corporate Governance in ITC shall take place at three interlinked levels, namely -

1. Strategic supervision by the Board of Directors
2. Strategic management by the Corporate Management Committee
3. Executive management by the Divisional Chief Executive assisted by the Divisional Management Committee

It is ITC's belief that the right balance between freedom of management and accountability to shareholders can be achieved by segregating strategic supervision from strategic and executive management. The Board of Directors (Board) as trustees of the shareholders will exercise strategic supervision through strategic direction and control, and seek accountability for effective strategic management from the Corporate Management Committee (CMC). The CMC will have the freedom, within Board approved direction and framework, to focus its attention and energies on the strategic management of the Company. The Divisional Chief Executive, assisted by the Divisional Management Committee, will have the freedom to focus on the executive management of the divisional business.

The 3-tier governance structure thus ensures that:

(a) Strategic supervision (on behalf of the shareholders), being free from involvement in the task of strategic management of the Company, can be conducted by the Board with objectivity, thereby sharpening accountability of management.

(b) Strategic management of the Company, uncluttered by the day-to-day tasks of executive management, remains focused and energized; and

(c) Executive management of the divisional business, free from collective strategic responsibilities for ITC as a whole, gets focused on enhancing the quality, efficiency and effectiveness of its business.
6.4.4 Roles

The core roles of the various entities at the three levels of Corporate Governance are as follows:

6.4.5 Board of Directors (Board):

The primary role of the Board of Directors is that of trusteeship to protect and enhance shareholder value through strategic supervision of ITC, its wholly owned subsidiaries and their wholly owned subsidiaries. As trustees they will ensure that the Company has clear goals relating to shareholder value and its growth. They should set strategic goals and seek accountability for their fulfillment. They will provide direction, and exercise appropriate control to ensure that the Company is managed in a manner that fulfills stakeholder aspirations and societal expectations. The Board must periodically review its own functioning to ensure that it is fulfilling its role.

The ITC Board will be a balanced Board, consisting of Executive and Non-Executive Directors, the latter including independent professionals. Executive directors, including the Executive Chairman, shall not generally exceed 1/3rd of the total strength of the Board. The Non-Executive Directors shall comprise eminent professionals, drawn from amongst persons with experience in business / Finance / Law / Public enterprises. Directors shall be appointed / re-appointed for a period of three to five years, and in the case of Executive Directors up to the date of their retirement, whichever is earlier. The Board shall determine from time to time the retirement age for both Executive and Non-Executive Directors. The Board shall specify the maximum number of company Directorships which can be held by members of the ITC Board.

Non-Executive Directors are expected to play a critical role in imparting balance to the Board processes by bringing an independent judgment to bear on issues of strategy, performance, resources, standards of company conduct, etc.

The Board shall meet at least six times a year and as far as possible meetings will be held once in two months. The annual calendar of meetings shall be agreed upon at the beginning of each year. As laid down in the Articles of Association of the Company, the quorum for meetings shall be one third of members and decisions shall be taken by simple majority, unless statutorily required otherwise. Meetings shall be governed by a structured agenda. All major issues included in the agenda shall be backed by comprehensive background
information to enable the Board to take informed decisions. Agenda papers, as far as practicable, shall be circulated at least three working days prior to the meeting. Normally items for the Board Agenda, except those emanating from Board Committees, should have been examined by the CMC. Minutes shall be circulated within 15 working days of the meeting and confirmed at the next meeting. Board decisions shall record the related logic as far as practicable.

The Board shall have the following Committees whose terms of reference shall be determined by the Board from time to time:

- **Audit Committee**: To provide assurance to the Board on the adequacy of internal control systems and financial disclosures. The Head of Internal Audit will act as co-ordinator to the Audit Committee, but will be administratively under the control of the Director accountable to the Board for the Finance function.
- **Compensation Committee**: To recommend to the Board, compensation terms for Executive Directors and the senior most level of management below the Executive Directors.
- **Nominations Committee**: To recommend to the Board nominations for membership of the CMC and the Board, and oversee succession for the senior most level of management below the Executive Directors.
- **Investor Grievances Committee**: To look into redressal of shareholder and investors grievances, approval of transmissions, sub-division of shares, issue of duplicate shares, etc.
- **Sustainability Committee**: The role of the Sustainability Committee is to review, monitor and provide strategic direction to the Company’s sustainability practices towards fulfilling its triple bottom line objectives. The Committee seeks to guide the Company in integrating its social and environmental objectives with its business strategies.

The composition of these Committees will be as follows:-

Audit Committee includes Directors of the Company, as may be decided by the Board, with at least 3 members all being Non-Executive Directors with majority of them being independent; and the Director accountable to the Board for the Finance function, Head of Internal Audit and representative of External Auditors as Permanent Invitees with the
Company Secretary as the Secretary. One of the Independent Directors is to be determined by the Board.

Compensation Committee comprises of Non-Executive Directors as may be decided by the Board, with the Director accountable to the Board for the HR Function as the Secretary. One of the Independent Directors, to be determined by the Board.

Nominations Committee consists of the Executive Chairman and all the Non-Executive Directors and Executive Chairman.

Investor Grievances Committee comprises of Directors of the Company, as may be decided by the Board, with the Company Secretary as the Secretary. One of the non-Executive Directors, to be determined by the Board.

The Sustainability Committee presently comprises the Chairman of the Company and five Non-Executive Directors, three of whom are Independent Directors. The Chairman of the Company is the Chairman of the Committee.

Normally meetings of the Board Committees shall be convened by their respective Chairman. However, any member of the Committee may, with the consent of the concerned Chairman, convene a meeting of the Committee. The Chairmanship of Board Committees shall be for two years at a time. Signed minutes of Board Committee meetings shall be tabled for the Board's information as soon as possible. However, issues requiring Board's attention / approval should be tabled in the form of a note to the Board from the Committee Chairman.

In the event there are no issues to be brought before the Board by the Audit Committee, the Chairman of the Audit Committee shall submit 'NIL' reports to the Board.

6.4.6 Corporate Management Committee (CMC)

The primary role of the CMC is strategic management of the Company's businesses within Board approved direction / framework. The CMC will operate under the superintendence and control of the Board. The composition of the CMC will be determined by the Board (based on the recommendation of the Nominations Committee), and will consist of all the Executive Directors and three or four key senior members of management. Membership of the CMC shall be reviewed by the Nominations Committee annually. The CMC shall be convened and chaired by the Executive Chairman of the Company. The Company Secretary shall be the Secretary of the CMC. The quorum for meetings will be 50% of the members, subject to a
minimum of three members. Decisions will be taken by simple majority. Minutes of CMC meetings shall be tabled before the Board for its information. However, issues arising from CMC Meetings and requiring Board's approval / attention should be tabled in the form of a note from the relevant Executive Director. Agenda items shall be backed by comprehensive notes from the concerned member / invitee, along with DMC approval where applicable. Agenda papers, as far as practicable, shall be circulated at least three days prior to the meeting. The CMC shall normally meet once a month.

6.4.7 Executive Chairman of ITC

The Executive Chairman of ITC shall operate as the Chief Executive for ITC as a whole. He shall be the Chairman of the Board and the CMC. His primary role is to provide leadership to the Board and CMC for realising Company goals in accordance with the charter approved by the Board. He shall be responsible for the working of the Board, for its balance of membership (subject to Board and Shareholder approvals), for ensuring that all relevant issues are on the agenda, for ensuring that all directors are enabled and encouraged to play a full part in the activities of the Board. He shall keep the Board informed on all matters of importance. He shall preside over the General Meetings of shareholders. As Chairman of the CMC he will be responsible for its working, for ensuring that all relevant issues are on the agenda, for ensuring that all CMC members are enabled and encouraged to play a full part in its activities.

6.4.8 Executive Director:

a) As a member of the CMC, he should contribute to the strategic management of the Company's businesses within Board approved direction / framework.

b) As Director accountable to the Board for a business (Line Director), assume overall responsibility for its strategic management, including its governance processes and top management effectiveness.

c) As Director accountable to the Board for a wholly owned subsidiary, or its wholly owned subsidiary (Line Director), act as the custodian of ITC's interest and be responsible for their governance in accordance with the charter approved by the Board.

d) As Director accountable to the Board for a particular corporate function (Line Director), assume overall strategic responsibility for its performance.
6.4.9 Divisional Management Committee (DMC):

Executive management of the divisional business aims to realize tactical and strategic objectives in accordance with CMC / Board approved plan. Composition of the DMC shall be determined by the Line Director with the approval of the CMC. The Divisional CEO shall convene and chair the DMC meetings. If the Divisional CEO, for any reason, is not in a position to convene a required DMC meeting, he shall in writing delegate the power to convene and chair the required meeting to one of the DMC members identified by name. Such delegation should be either for a specific meeting or for meetings to be held during a specific period of time. It cannot be a general, open-ended delegation. The key functions of the Division shall be represented on the DMC. Normally the Divisional Financial Controller, in addition to being a member, shall act as the Secretary to the DMC and will be responsible for circulation and custody of agenda notes and minutes. The DMC shall generally meet at least once a month to review Divisional performance and related issues. Quorum for meetings shall be 50% of the members subject to a minimum of three members. Decisions will be taken by simple majority. Minutes of meetings shall be tabled before the CMC for its information. Agenda items shall be backed by comprehensive notes from the relevant member / invitee. Agenda papers, as far as practicable, shall be circulated at least three days prior to the meeting.

6.4.10 Divisional CEO:

The Divisional CEO shall function as the Chief Operating Officer with executive responsibility for day-to-day operation of the Divisional business, and shall provide leadership to the Divisional Management Committee in its task of executive management of the Divisional business.

The corporate governance policy also adhere a Code of Conduct, which is adopted by the Board of Directors, is applicable to Directors, senior management and employees of the Company. The Code is derived from three interlinked fundamental principles in ITC’s policy, viz. good corporate governance, good corporate citizenship and exemplary personal conduct in relation to the Company’s business. The Code covers ITC’s commitment to sustainable development, concern for occupational health, safety and environment, a gender friendly workplace, transparency and auditability, legal compliance and the philosophy of leading by personal example.
6.5 Conclusion

Thus, the period of 90s and the entire BAT-ITC tussle, FERA violations turned into a learning experience for ITC Ltd. During this time, the ITC found itself trapped in meeting the expectations of various stakeholders which ultimately led to certain corrective actions from the company’s management. All these governance norms with regard to the Board of Directors, Board Committees and their structures follow the recommendations of National and International Committees on corporate governance.