CHAPTER – ONE

CORPORATE GOVERNANCE –
A QUESTION OF ETHICS.

PROLOGUE

The introductory part of the study gives the conceptual and philosophical background of the study. The researcher discusses the concept of corporate governance, its objectives, significance and its direct relation with business ethics which is a subject of contemporary significance in the present management and contemporary business environment. The first chapter of the study has been devoted to the theoretical discussion on corporate governance and its various dimensions in the present day business world.

The researcher has also developed upon basic principles of corporate governance and social responsibility of business in the present times. This part of the study gives mainly material collected from secondary sources i.e. published sources, business magazines, industrial journals, business newspapers and research
articles and current literature on the subject. The present chapter has been discussed under the following heads:

1.1 CONCEPT AND ORIGIN OF CORPORATE GOVERNANCE.

'Corporate Governance', despite some feeble attempts from various quarters, has remained ambiguous and often misunderstood phrase. For quite some time, it was confined to only corporate management. It is not so. It is something much broader for it must include a fair, efficient and transparent administration to meet certain well-defined objectives. Corporate governance also must go beyond law. Corporate governance starts where law ends. The quantity, quality and frequency of financial and managerial disclosure, the degree and extent to which the Board of Directors (BOD) exercise their trustee responsibilities and the commitment to run transparent organization – these should evolve due to interplay of many factors and the role played by more progressive elements within the corporate sector. In India, a strident demand for evolving a code of good practices by the corporate themselves is emerging.

In general, why is governance becoming more and more complex and diverse, whether it is corporate governance, fiscal
policy, public policy or in any other form? In the Indian context, a good answer has been provided in a commemorative lecture at National Institute of Public Finance and Policy, New Delhi. It reads “Governance is becoming more complex because the policy in fragmented. For every reformer, you will find an anti-reformer. For every measure of reform, you will find some opposition. The task is difficult enough to put together a government which commands majority and still more difficult to continue to keep that majority for a long enough period. The people seem to elect, for a variety of reasons, parties and individuals who do not share a basic ideology or basic philosophy.

In fact, it is sometimes more comfortable to go back to the age of ideology when at least you knew that 350 or so individuals of one ideology could get elected – even if it was an imperfect ideology, at least some ideology linked them. Today, one can never say, to any degree of certainty, what will happen to a bill or what will happen to a measure? It is quite possible that someone in your own constituency will stand up and say, “we do not agree”. So given the fragmented polity, it is even more necessary to find some convergence on a few economic issues, particularly issues concerning fiscal and public policy.”
Thus, for corporate governance to succeed, some convergence on a few economic issues is vital. According to Raja J Chelliah, "the official economic doctrine in India has not been modified to take account of the serious problems of governance that have arisen over the years in our country. It is felt that the deplorable weaknesses in the system of governance in our country can only be remedied through a movement of moral regeneration backed by sufficient pressure by an enlightened public. Institutional and structural changes are called for in addition to moral exhortation." 

CORPORATE GOVERNANCE

What then is Corporate Governance? It is a phrase which implies transparency of management systems in business and industry, be it private sector, public sector or the financial institutions – all of these are corporate entities. Just as industry seeks transparency in government policies and procedures, so also, the debate on Corporate Governance seeks transparency in the corporate sector. **Corporate Governance, simply stated is therefore, a system by which corporate entities are directed and controlled.** It encompasses the entire mechanics of the functioning of a company and attempts to put in place a

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system of checks and balances between the shareholders, directors, auditors and the management.

Corporate Governance is basically no more than getting appropriate controls over what management does for some public bodies such as shareholders and to ensure some supervision over the management structure itself. The idea is to hold the management responsible for what it does within its jurisdiction.

However, it is also well known that though the laws of any country try to make sure that those who sin ought to be punished but this does not prevent everyone from sinning. The same is true of corporate governance. Even when you have a code, there would be transgressions. We still do not have one in India – though the (CII) National council had set up a National Task force on Corporate Governance under Mr. Rahul Bajaj, CMD, Bajaj Auto Limited in mid 1996. The task force had since recommended “desirable Corporate Governance Code.”

The concept of Corporate Governance, as brought out in “Corporate Governance: Time for a Metamorphosis” states it “as a system of structuring operating and controlling a company with a view to achieve long-term strategic goals to satisfy shareholders, creditors, employees, customers and
suppliers with the legal and regulatory requirements, apart from meeting environmental and local community needs. It leads to the building of a legal, commercial and institutional framework. It also demarcates the boundaries within which these functions are performed.”

Yet another definition of Corporate Governance was provided by the Advisory Board of the National Association of Corporate Directors (NACD), New York. As per NACD “Corporate Governance ensures that long-term strategic objectives and plans are established and that the proper management structure (Organization, systems and people) is in place to achieve those objectives, while at the same time making sure that the structure functions to maintain the corporation’s integrity, reputation and responsibility to its various constituencies.”

In his “Role of Board of Directors in Emerging Dimensions”, Dr. K.R. Chandratre has explained the concept as “Corporate Governance is the expression which is not capable of being precisely defined. However, broadly speaking, corporate governance denotes direction and control of the affairs of the company. The role of corporate governance is to ensure that the directors of a company are subject to their duties,
obligations and responsibilities to act in the best interest of their company, to give direction and to remain accountable to their shareholders and other beneficiaries for their actions.”

Salim Sheikh and William Ress in their “Corporate Governance and Corporate Control” explicitly state (what was implicitly inferred in other definitions) that “Corporate Governance is also concerned with the ethics, values and morals of a company and its directors.”

A review of various definitions and views brings out that in its simplistic form Corporate Governance can be stated “as a process of direction, supervision and accountability of corporations.”

1.2 CORPORATE GOVERNANCE AND SOCIAL RESPONSIBILITY OF CORPORATES.

Corporates are born, exist and grow in a society and hence owe an obligation towards betterment of society. It is, therefore, desirable that a business firm must view itself as a socially responsive entity and assume wider responsibilities. It is in fact

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in the long-term interest of the company to discharge their social obligations and responsibilities for it mitigates the pressure and the incidence of governmental interventions. Kenneth Andrews, an eloquent advocate of social responsibility says “Corporate executives of the caliber, intelligence and humanity required to run substantial companies can not be expected to confine themselves to the narrow economic activity and to ignore its social consequences.”

In recent years, there has been increasing resistance from various sections of society against corporates incessant drive to maximize profits. They must accept the social responsibility of giving due weightage to protect the environment and safeguard the interests of customers, employees, suppliers and the community, rather than concentration on maximisation of profits. The corporates also need to provide work to the employees in a manner that is dignified, fulfilling and meaningful. Seen in this light, **corporate governance is nothing but ushering in better and fair relations between all the stakeholder, besides being environment friendly.**

The corporate sector needs to accord utmost importance to moral, values and ethical business. According to Dr. G.B. Rao, the Past President of ICSI, “Corporate Governance is perhaps the only
route which would enable Indian businessmen to cut through the maze of prevalent questionable practices, indefensible management attitudes to stake holders and penetrable non-disclosures in their bid to integrate themselves with a far more demanding world order."

Present day managers are increasingly concerned about the social and ethical issues that they and their organisations are facing. This is happening throughout the world and India is no exception. Managers manage organisations which exist within a given society. Since a society is a broader framework within which organisations operate, there are many social issues which impinge on the operation of organisations.

Such issues have to be taken care of by managers specially when our society is pluralistic with the existence of many interest groups. The most important social issue that managers, particularly in business organisations, must take into account is social responsibility of managers.\(^3\) Therefore, the analysis of social responsibility of managers and issues and problems involved therein is worthwhile for identifying their role in this respect.

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Social responsibility (SR) of managers particularly in business organisations has, of late, been one of the most talked about and widely supported subjects. Traditionally business's basic objective has been defined in terms of profit maximisation. It is said that main business of business is business. The first break came in the 1930s when the view was advanced and accepted that managers of large companies must make decisions which maintain an equitable balance among the shareholders, employees, customers, suppliers and general public. Managers were considered trustees for these interests. Such a view was later developed as the social responsibility and corporate community obligation.

The phrase, 'social responsibility' is widely used in the literature of Sociology, Anthropology, Economics, Politics, and Business Management. However, conceptually as well as in practice also, this has been a volatile, vague, and confused area. Conceptually, people are not very clear what is the exact meaning of social responsibility and what they are expected to do under this.

From practical point of view, the response from business has gone on providing a spectrum ranging from mere lip-sympathy to multi-lakh rupees concrete programmes in our country. From
conceptual point of view, social responsibility has been defined by Davis as follows:

"Social responsibilities refer to the businessman's decisions and actions taken to reasons at least partially beyond the firm's direct economic or technical interest."\(^4\)

This is a broad definition of social responsibility and prescribes actions not related to the interests of the organizations. Still broader view has been suggested by Andrews, when he says that:

"By social responsibility, we mean the intelligent and objective concern for the welfare of society that restrains individual and corporate behaviour from ultimately destructive activities, no matter how immediately profitable, and leads in the direction of positive contributions to human betterment, variously as the latter may be defined."\(^5\)

Both of these definitions prescribe some actions by managers for the betterment of the society but do not prescribe the actions precisely. Therefore, most business managers prefer words to

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them connote a fixed obligation. They prefer such synonyms as social concern, social programmes, social challenge, social commitment, or concern with public problems. However, the term 'social responsibility' has been widely recognized and its operational definition may be as follows:

“Social responsibility contends that management is responsible to the organization itself and to all the interest groups with which it interacts. Other interest groups such as workers, customers, creditors, suppliers, government and society in general are placed essentially equal with shareholders.”

On the basis of this definition, following features of social responsibility can be identified:

- The social responsibility contains three types of behaviour – positive, neutral and negative. The negative and neutral aspects of behaviour are as important as positive.
- Every person in the society has a social obligation to fulfil. However, the emphasis is on social responsibility of management as a group because it is in a position to use the resources of the society in the way it likes. Therefore, it must be conscious about social responsibility.

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Social responsibility involves fulfilling obligations to various parties concerned with the functioning of an organization. Some of these parties are concerned directly. Others may be concerned indirectly.

The standards fixed for fulfilling obligations to various parties are to be decided according to social norms and expectations. Therefore, these obligations may vary from society to society.

SR requires the identification of various interest groups which may affect the functioning of a business organisation and may also be affected by its functioning. Normally various groups associated with a business organisation are shareholders, workers, customers, creditors, suppliers, government and society in general. The management owes responsibility towards all those groups. Therefore, management should show a standardised norm of behaviour.

However, the standard norm of behaviour may not be universal. We are more concerned with Indian situation while prescribing the norms of behaviour in respect of fulfilling obligations to various interest groups. Various norms have been suggested through seminars and conferences in our country and our attempt is to present an integrated view.
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SHAREHOLDERS

The first responsibility of management is to protect the interest of shareholders. The interests of majority of shareholders and large minority of shareholders are generally well protected through either direct participation in the management actions or they have real power to intervene, if necessary. However, large number of minority shareholders are not in such a position. Therefore, management is expected to use the resources provided by them effectively and to protect their interests. They should be informed about the functioning of the organisation adequately and timely. Though, the provisions of the Companies Act provide safeguard to the investment made by shareholders, whether minority or otherwise, management can find loopholes in these. Therefore, management has a responsibility to provide proper safeguard to the money invested by shareholders.

WORKERS

Workers have direct interest in an organisation because by working there, they satisfy their needs. The traditional economic concept of organizational functioning does not give workers their proper share in the distribution of income. The owners and managers have too much power under the economic state of
affairs. Thus, it is the management’s responsibility to protect the interest of workers in the organisation. This can be done by the management in the following ways:

- Management should treat workers as another wheel of the cart.
- Management should develop administrative process in such a way that promotes cooperative endeavour between employers and employees.
- The management should adopt a progressive labour policy based on recognition of genuine trade union rights – participation of workers in management, creating a sense of belongingness, improving their working and living conditions.
- Management should pay fair and reasonable wages and other financial benefits to workers.

**CUSTOMERS**

A customer may broadly be defined as a person who has a favourable impression of a company and its products and services. Thus, a person may be categorised as customer even though he may not have committed the act of buying; he may be only a potential customer. Management owes a primary obligation to

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give a fair deal to customers. This can be done in the following ways:

✦ Customers should be charged a fair and reasonable price.
✦ The supply of goods and services should be of uniform standard and of reasonable quality.
✦ The distribution of goods and services should be widespread so that customers do not face any problems in procuring them.
✦ Management should not indulge in profiteering, hoarding, or creating artificial scarcity.
✦ Management should not mislead the customers by false, misleading and exaggerated advertisements.

**CREDITORS, SUPPLIERS & OTHERS**

Creditors, suppliers, and other groups affect the organisation in various ways. Therefore, management is responsible to fulfil its obligations to them. This can be done in the following ways:

✦ Management should create healthy and cooperative inter-business relationship between different businesses.
✦ Management should provide accurate and relevant information to creditors and suppliers.
Payments of price of materials, interest on borrowings, other charges should be prompt.

**GOVERNMENT**

Government is very closely related with the business system of the country. It provides various facilities for the development of business. No doubt, government exercises controls over business, but these controls are meant for overall development of business. Management can discharge its obligation to government in the following ways:

- Management should be law-abiding citizen.
- Management should pay taxes and other dues fully, timely and honestly.
- It should not corrupt public servants and democratic process.
- It should not buy political favour by any means.

**SOCIETY**

Organisations exist within a social system and get facilities from the system. Therefore, they owe obligations to the society as a whole. It is the obligation of management to protect the interest of society because management process goes a long way in
determining the life in the society. In this context, management should behave in the following ways:

- Management should maintain fair business policies and practices.
- It should set up socially desirable standards of living and avoid ostentation and wasteful expenditure.
- It should play a proper role in civic affairs.
- It should provide and promote general amenities and help in creating better living conditions in general.
- It should set example for others about how developmental programmes can be taken for the benefits of the society.\(^7\)

1.3 **OBJECTIVES AND SIGNIFICANCE OF CORPORATE GOVERNANCE.**

Corporate governance is a newly introduced system for managing a company in the best interest of all its stakeholders though in the context of state administration, the concept of governance is quite old, where it is referred to as the system of directing and controlling the activities of a state, particularly in princely states and empires. We may find the concept of state governance even in the writings of Kautilya (Chankaya).

\(^7\) Kumar, Surendar: Corporate Governance, Galgotia Publishing Company, New Delhi, 2005, p. 4-5.
Corporate governance is a system by which companies are directed and controlled based on code for good corporate practices. The code for corporate governance is required because the company laws, which prescribe how a company can be managed, only prescribe procedural matters and the penal provisions if any offence is committed in the form of non-conformity to these procedures. These do not prescribe good corporate management practices. Code of corporate governance prescribes such practices.

Corporate governance has been applied in many countries and international institutions. Many countries have formulated code of corporate governance, India is also in the process of formulating its own code. At the corporate level, many companies have formulated code of corporate governance such as Tata Group to be followed by all group companies, RPG Group, Reliance, etc. Some MNCs operating in India, follow foreign code, e.g., ICI Limited has adopted Anglo-Saxon Principles of Corporate Governance.

**CONTENTS OF CORPORATE GOVERNANCE CODE**

The researcher would like to explain the main subject of corporate governance in the form of corporate governance
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contents. A corporate governance code usually contains the following matters:

- **CONSTITUTION OF BOARD OF DIRECTORS:** Constitution of board of directors, role of non-executive directors, its meetings, key matters that must be brought before the board, etc.

- **DISCLOSURE OF INFORMATION:** Disclosure of financial and other information in the company’s annual accounts and reports as well as periodical disclosure.

- **MANAGEMENT PRACTICES:** Management practices to protect the interests of share-holders, consumers, financiers, creditors, distributors, government and society.

Usually corporate governance code runs into many pages depending on the contents of the code and the degree of elaboration of each content. Exhibit presents code of corporate governance of HLL & Godrej in brief:

Code of corporate governance of HLL & Godrej is very widely elaborated and includes: its commitment, board structure and practices, transparency and disclosure, corporate ethics and business policies.
**COMMITMENT:** HLL & Godrej are committed to achieving the highest international standards of corporate governance, recognising that the management is accountable to all stakeholders for good governance – including shareholders, employees, the government and creditors. HLL & Godrej believe that their key decisions must serve underlying goals of enhancing shareholder value over a sustained period of time, and achieving the definite and measurable performance targets that have publicly been set out by the companies. To this end, HLL & Godrej consistently aim at achieving increased level of transparency, accountability and equity, in all facets of their operations.

**BOARD STRUCTURE AND PRACTICES:** HLL & Godrej believe that the board of directors is a balanced one and ensures adequate representation to all stakeholders; provides the company with the benefits of the accumulated skills, experience and wisdom of an independent body of professionals. In addition to the matters statutorily requiring board approval, all major decisions involving, inter-alia, mobilisation of resources, new investments and capital expenditure, acquisitions, risk management, and technology are brought before the board for its decisions. To assist the board, various committees are constituted like
audit committee, finance committee, share transfers committee, etc.

**TRANSPARENCY AND DISCLOSURE:** HLL & Godrej believe that increased transparency and enhanced disclosure promote better corporate governance. They believe that the accounts are prepared on the basis of the highest accounting standards and practices including US GAAP and International Accounting Standards. The accounts are audited by the statutorily appointed Indian auditors, and a firm of international accountants. HLL & Godrej believe in adequate information sharing, both financial and non-financial, with all stakeholders in terms of time and volume – quantity and quality.

**CORPORATE ETHICS:** HLL & Godrej believe that an effective corporate governance process transcends integrity and efficiency and encompasses all of the corporation's relationships. They believe that any business conduct can be ethical only when it rests on the nine core values of: honesty, integrity, respect, fairness, purposefulness, trust, responsibility, citizenship, and caring.

In order to ensure adherence to corporate ethics and fair business practices, HLL & Godrej have codified ethics policy and business policy.
These policies are on:

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<tr>
<th>Code of Ethics Policy</th>
<th>Business Policy</th>
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<tr>
<td>Conflict of Interest</td>
<td>Fair Market Practices</td>
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<td>Payments and Gifting</td>
<td>Inside Information</td>
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<td>Receipt of Gifts</td>
<td>Records and Accounting Integrity</td>
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<td>Purchases through Suppliers</td>
<td>External Communication</td>
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<td>Appointment of Agents, Consultants, and Representatives</td>
<td>Work Ethics and Personal Conduct</td>
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<td>Inside Trading</td>
<td>Health and Safety Environment Quality</td>
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Source:  

SIGNIFICANCE OF CORPORATE GOVERNANCE

A company is an enterprise, authorised by law to conduct business. Governance implies a degree of control to be exercised by key stakeholders’ representatives for the furtherance of

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corporate growth and protection of stakeholders’ interests. Being guided by the principle of shareholders democracy, companies will have to make clear to shareholders without any concealment about their policies in running the business. In the area of financial decision making, it is obvious on the part of shareholders and other stakeholders to judge whether the company’s management has the ability to undertake various projects with high growth potentials.

In this context, the Board of Directors is to determine corporate purpose and set broad directions for their achievement by executive directors and managers. Corporate governance ensures how effectively the Board of Directors and management are discharging their functions in building and satisfying stakeholders’ confidence (Srikant, 1997). In the words of Catherwood, corporate governance to most people means the way company manages its business in a manner that is accountable and responsible to some one usually the shareholder in a wider interpretation, responsibility and accountability is seen to be a broader audience that also includes company’s stakeholders such as employees, suppliers, customers and local community. It suggests ethics and morals as well as best practices.
According to CII’s draft, corporate governance deals with laws, procedures, practices and implicit rules that determine a company’s ability to take managerial decisions vis-à-vis its claimants – in particular its shareholders, creditors, the state and employees. There is a global consensus about the objective of good corporate governance: maximizing long term shareholders value (Confederation of Indian Industries, 1997). Since shareholders are residual claimants, this objective follows from the premise that in well performing capital and financial markets, what maximizes shareholder value must necessarily maximize corporate value and best satisfy the claims of creditors, employees and the state.

In order to protect and promote the interests of all stakeholders, corporate governance should encompass well-defined set of systems and processes. Systems include structural and organizational aspects like constitution of board of directors, their optimum size, compositions, qualifications, role and competencies, frequency of change of board members and nominee directors. The organization of different committees by board members such as management committee, share transfer committee, executive nomination and compensation committee, investment committee, audit committee and budget committee...
also, etc., forms an integral part of the system for sound corporate governance.

While the main board of the company would deal with major policy decisions and strategic directions that the company should take, the constitution of these committees makes focused attention on various aspects of company’s working. The board along with different committees and chief executive officer (CEO) should devise right kind of management processes for organizational effectiveness. The management include performance management systems, periodic business reviews, environmental audit, energy audit, secretarial and legal audit, benchmarking customer satisfaction, benchmarking employee’s satisfaction, having surveys about them and so on (Iyer, 1997). Evidently, the efficacy of corporate governance hinges on these well-defined systems and processes.

In the international arena, studies reveal that sound and effective corporate governance enhances corporate dynamism and flexibility, minimizes overall cost of economic adjustment and changes and improves global economic performance. Good governance practices entail active participation of shareholders in the direct and indirect management of corporation through the board of directors and an arrangement of productive checks and
balances among shareholders, board of directors and management of corporations (Rao and Lee Sing, 1996).

Sound corporate decision making has emerged as the direct and positive outcome of good corporate governance system. One would hardly deny that the high standard of living enjoyed by the people of the developed countries are due to phenomenal success of their businesses. Reasons attributed to business success are sound top management decisions, meaningful roles and functions played by directors and corporate officers like CEOs, CFOs and well designed legal and institutional settings. Hence, in the global scene, good corporate governance remains the key to business success and prosperity of the society.\(^9\)

**CHANGING ENVIRONMENT AND THE NEED FOR CORPORATE GOVERNANCE**

A significant development in the later part of this century is the growing role of the market in both industrialized and developing world. This growing importance of market and consequent premium on competitiveness is related to global integration of product, capital and labour markets. Hence, the spread of capitalism and concomitant globalisation demand

\(^9\) Corporate Governance: The Institute of CS of India, New Delhi, 2004.
efficiency, corporate culture, model code of conduct and business ethics for the very survival and growth of corporations in the world market place. Investors today are demanding more transparency in business operations, adequate and qualitative financial and non-financial information, and more accountability of company's board and management than ever before. Good corporate governance must address these issues.

In words of Cadbury (1998), as the world has shrunk, major international investors have moved beyond their domestic markets in search of attractive investment opportunities abroad and also look to spread their risks geographically. As they do so, they demand high and consistent standards in terms of both financial reporting and treatment of shareholder's interests, making board room accountability and standards of corporate governance a global issue. Furthermore, today there is an increasing need among growing companies to tap international capital markets for funds. As they compete to attract investments and raise capital world wide, high standard of governance of companies is demanded by investors. Hence, corporate governance is emerging as an important issue in the international business.
Another disquieting trend is that during 1980s and early 1990s the global economy exhibited poor economic performance. The OECD countries and many well-known multinational companies like, GM, IBM, Eastern Kodak, etc., faced series of economic difficulties. Analysts strongly believe that corporate internal control i.e., corporate governance system, has failed to deal effectively with the challenges of structural changes and adjustment. Hence, there is an urgent need to strengthen corporate governance practices in order to cope up with changing environment.

So far as India is concerned, the country is in the process of adopting a policy of liberalization of markets, privatization of ownership and globalization of the economy. The changing needs and ever growing expectations of the information rich customers, fast growing competition, government thoughts on exports, etc., are cumulatively forcing the top management of the corporate world to be on their toes for a new paradigm (Sastry, 1997).

The governance of companies in India today requires high degree of professionalism of the board, transparent operations and disclosures through fairness in accounting and reporting of business operations. This will certainly attract both domestic and foreign investors for augmenting financial and technological
resources required for development. As such, there is a paradigm shift from traditional philosophy to modern thinking.

1.4 FUNDAMENTAL PRINCIPLES OF CORPORATE GOVERNANCE.

In Canada, the Toronto Stock Exchange constituted a committee in 1994 to propose guidelines for sound and effective governance of business corporations. Attaching significance to the board, the committee specified that the main responsibility of the board of directors is to supervise and control company's activities. More precisely, the board should ensure the adoption of strategic planning process and communication policy. It should also ensure the integrity of company's internal information and management systems. The board should also seek to ensure on orderly succession of senior executives by selecting, training and supervising them at appropriate time.

Finally, the board should identify risks including those arising out of the use of derivative instruments. Above all, the committee says that the corporate governance should have the first and foremost capacity to increase shareholder's value and

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corporate profitability. Experts are also of the opinion that these factors which are important for sound governance today would also remain relevant in the year 2000 (Delorme, 1996).

In UK, the financial aspects of corporate governance were deliberated in detail by the Cadbury Committee in 1991. The major chunk of the report dealt with the aspects of financial transparency and related role of directors and auditors. The committee stipulates that all major investment and disinvestment proposals, changes in financial and marketing structure, important appointments and findings of the internal auditors, have to be presented, discussed and approved by the board of directors.

The board should be briefed periodically on the progress of various projects of the company under implementation. Transparency, being the hallmark of corporate governance, it must be ensured that no vital information is concealed from the board. The committee also feels that in the interest of corporate democracy, separation of power is desirable at the top level. There should be such a balance of power and authority that no individual enjoys unfettered powers of decision making.
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The Cadbury Committee has stated emphatically that directors are primarily responsible for maintaining adequate accounting records, and the accuracy of such records depends on the prevalence of sound system of internal control. It recommends that the directors should make a statement in their reports and accounts on the effectiveness of the system of internal control, and the auditors should also report on this. The Cadbury Report has also stressed the need for setting up audit committees comprising non-executive directors.

According to Sir Adrian Cadbury, the author of the report, the theme of code of best practice is full transparency with shareholders who are entitled to a clear picture of the company. He further emphasized that companies must make compliance statements and the compliance itself is a matter between boards and their shareholders (Sinha, 1998). In UK, the implementation of the recommendations of Cadbury Committee has made a headway as the London Stock Exchange has made it mandatory for all companies to state in their balance sheets whether or not they have complied with the financial aspects of corporate governance.
INDIAN SCENARIO

Admittedly corporate India has been transforming during the last five decades and more so since mid-nineties with the adoption of the policy of economic liberalisation by its government. However, it is still confronted with certain maladies. Shareholders have so far remained scattered, mute and fervently obliged to management for dividends and petty gifts offered at the annual meetings. They give their consents obligingly to almost all resolutions enabling management to fulfil their vested interest. There is a lack of accountability and transparency in the average Indian company.

According to a survey, family shareholding in big business groups averaged to a mere 3.3 percent of the aggregate paid up capital (Fernando, 1997). Companies give priority to short term interests and surprisingly for the benefit of controlling minority (family shareholders) at the cost of long run interest of the company and its majority shareholders. The Institute of Company Secretaries of India has also highlighted about the inadequacy of information disclosure in the annual reports of majority of Indian companies. For the past two years, the air is thick with talk of corporate governance, disclosure, transparency and shareholders value.
But judging so far, Indian companies fall way behind of these ideas (Basu, 1998). These deficiencies are to be corrected if Indian companies are to become robust growth engines and responsible corporations benefiting all its stakeholders. The Confederation of Indian Industry (CII) has constituted a committee under the chairmanship of Dr. Omkar Goswami to prepare a draft report on corporate governance. The draft report was duly considered by a twelve-member task force headed by Bajaj Auto CEO, Rahul Bajaj. The finally approved draft entitled “Desirable Corporate Governance in India – A Code” is fairly comprehensive and contains provisions for bringing about qualitative changes in the corporate governance practices prevailing in India.

The important features of CII’s code are:

- As the key to good corporate governance lies with the well functioning board of directors, the full board which should be single tiered, should meet at intervals of two months and at least six times a year.
- The non-executive directors should comprise 30 percent of the board if one of them is the chairman.
The non-executive directors should comprise at least 50 percent of the board if the chairman and the managing director is the same person.

No individual should be a director on the boards for more than 10 companies at any given time.

Non-executive directors must be active, have defined responsibility and be conversant with profit and loss account, balance sheet, cash flow statement, financial ratios and have some knowledge of company laws.

Non-executive directors should be paid commission and offered with stock options for their professionals inputs besides their sitting fees.

Directors who have not been present for at least 50 percent of the board meetings should not be re-appointed.

The board should be informed of the operating plans and budgets, long term plans, quarterly divisional results and internal audit reports.

Details of defaults, payments for intangibles and foreign exchange exposures should be reported to the board.

An audit committee comprising at least three non-executive directors should be set up and given access to all financial information.

While accepting the corporate disclosure norms, as recommended by the Working Group on Companies Act
regarding financial and non-financial information, draft code recommended for disclosure of additional information in the annual report on the monthly average share prices, value added and financial performance of divisions and segments, should be adopted.

- Disclosure norms and levels followed at home should be the same as those required for GDR issues.

- In case, multiple credit ratings are obtained, all the ratings should be disclosed with comparisons explaining their significance.

- Major Indian stock exchanges should gradually insist upon compliance certificate signed by the CEO and the CFO clearly stating that accounting policies and standards have been followed. The management is also responsible for preparation, integrity and fair presentation of financial statement and the board has seen the company's system of internal accounting and administrative control through audit committee or directly.

- The Government must allow for greater funding to the corporate sector against the security of shares and other papers.

- Recommending for reducing the number of companies having nominee directors, the draft envisage that financial institutions (FIIs) should withdraw from company boards.
where their individual shareholding is 5 percent or less or the total FI holding is under 10 percent.

Companies that default on fixed deposits should not be permitted to accept further deposits, make inter-corporate loans or investments and declare dividend until the default is made good.

While chalk ing out the above wide ranging proposals, the CII task force candidly admits that these provisions are not static and are subjected to review within the next five years for incorporating necessary changes. Sir Adrin Cadbury also states that the code of corporate governance cannot be used uniformly in all the countries of the world. It is bound to differ from organisation to organisation and from country to country.

However, the basic principles of good governance i.e., clear responsibilities, a precise distinction between direction and management, checks and balances in the governance structure, effective financial control and transparency remains more or less valid for business corporations irrespective of the country to which they belong (Cadbury, 1997).

In January 1997, the business magazine “Business Today” engaged market researcher AIMS Research to conduct a survey to
identify the best board of directors among the country's corporates. The top 100 India's most valuable companies of March 1996 were taken as sample companies whose boards are rated on four parameters of corporate governance i.e., accountability, transparency, quality and independence.

The opinions of six constituencies of investors i.e., FIs, FIIs, brokers, banks, finance companies and general investors are considered. The survey reveals that the best five boards in India are Hindustan Lever, Telco, Bajaj Auto, HDFC and L&T (Business Today – AIMS Research Survey, 1997).

However, the performance of public enterprise boards in India is far from satisfactory. A study conducted by Mishra (1998) reveals that public enterprise boards in India have fallen much short of expectation of making them to operate effectively. Though the functions of board have been very clearly spelt out by the government, the board members do not exercise sufficient care to execute their responsibilities.

The board members rarely give strategic suggestions and desired counsel to CEO's for improving public enterprise's performance. Majority of public enterprise boards are found grossly lacking in giving definite direction by way of appraising
their policies, programmes and caution in relation to objectives for which such enterprises have been set up.

In this context, it is befitting to quote Omkar Goswami draft report which recommends that government shareholding in public sector enterprises (PSEs) be reduced to 24 percent in most cases and the provisions on government companies under Section 617 to 620 of Companies Act be eliminated. Drawing out a blue print for privatization, the report suggests different privatization strategies for different public enterprises. Private placement allocating certain percentage of shares in the hands of informed investors such as FIIs, who are not only better placed to monitor managers, but also enforce managerial performances by holding enough shares to effect a takeover.\(^1\)

\section*{1.5 CORPORATE GOVERNANCE AND ETHICS.}
\section*{1.6 VARIOUS DIMENSIONS OF CORPORATE GOVERNANCE.}

Late, Pt. Jawaharlal Nehru had always cherished the dream of creating a ‘Socialist Pattern of Society’. In 1947, S. Radhakrishnan had stated ‘unless we destroy corruption in high

places, root out every trace of nepotism, love of power, profiteering
and black marking which have spoiled the good name of the
country in recent times, we will not be able to raise the standard
of efficiency in administration as well as the production and
distribution of goods of life."

However, nothing of the sort happened. India had to witness
a number of scandals in high places during era of the ‘Licence Raj’.
Starting with Jeep scandal in 1948 and the HG Mudgal case in
1950, a series of scandals likes the Mundhra deal, the Partap
Singh Kairon’s mis-adventure in 1964, imposition of Emergency in
1977, the memory raising exercise for the party during Indira
Gandhi’s period, the HDW deal with Germany for submarines in
1981, the Bofors scandal of 1987, the Harsad Mehta’s scam of
1992 and finally the Jain Hawala case in 1995 were just a few
glaring examples of degeneration of values and unethical practices
in high places in political field.

Political corruption, no doubt has very high degree of
visibility and it makes sensational news. But it is chicken feed
compared to corporate corruption. As per S.S. Gill (The Pathology
of Corruption), unofficial estimates by the International Monetary
Fund (IMF), state that the Indians have stashed away at least
hundred billion dollars in foreign banks. According to US
research study, India’s capital flight to the United States during 1994 and 1995 was to the tune of four to eleven billion dollars.

Looking at the corporate ethics from another angle. According to one of our finance minister’s statement (The Pathology of corruption) “there are about four lacs registered companies in India. Forty percent of them do not file any income tax return. In the top bracket there are nearly thirteen hundred concerns which did not pay any tax till 1995-96 as they were treated as “Zero Tax” companies. Indian banks carry a burden of forty thousand crore rupees as bad and doubtful debts and practically the entire sum has been advanced as loans to corporate sector. Despite all the noise about the government pampering the public sector at the cost of private sector, till 1990, seventy four percent of the advances made by the government financial institution went to the latter and these are mostly the borrowers who pay no tax. After liberalisation this figure must have gone up.”

Thus, we have a situation where on the one hand the governments are incurring ever higher and increasing liabilities. On the other the corporate sector which has become the real accumulator of capital, is contributing less and less to the state exchequer.
Chapter One: Corporate Governance – A Question of Ethics

Luckily, there is now an increasing debate and rising demand in favour of ethics in all aspects of society, politics, administration, judiciary, business, media, family and personal life. We find wide exposure of unethical practices and criticism, which is relevant to holders of high political office and also to various corporate houses. With the increasing liberalisation and globalisation of Indian Economy, the driving forces for business ethics are getting further strengthened due to need to match the best global competitive standards of ethics. Competitive position of corporate to a large extent will be determined by the effectiveness with which their boards of Directors discharge their duties and responsibilities.

It is indeed a matter of shame that Transparency International had ranked India as the ninth most corrupt country in the world. It is also a matter of history that the extent of corruption that had infested British Public life about 150 years ago was much greater. Yet for nearly a hundred years now Britain was ranked as one of the cleanest countries in the world. How was this miracle achieved?

Ethics carry importance from the point of view of employees’ customers, shareholders, lenders, dealers and vendors all of whom form part of the corps of business stakeholders. All need to be
treated fairly and justly. Thus, "Ethics is a good business", the motto followed by the PHD Chamber of Commerce, rightly emphasising corporate ethics and good governance, becomes highly important in today's milieu.

Various dimension which interact and lead to Corporate Governance are:

- Legislation, Laws and infrastructure, codes of conduct for the lawmakers themselves.
- Corporates themselves – their values and concerns. Codes of conduct particularly at corporate level.
- Society – their values morals and awakening. Their responses to corrupt practices are expressed through pressure groups and media.

The pace of good corporate governance is set at the initial stage of statement of objectives, particularly the corporate finance objective. An objective function specifies what the decision-maker is trying to accomplish and by so doing provides a framework for analysing various decision rules. In most cases the objective function is slated in terms of maximizing some function or
variable (profits, size, value, social welfare) or minimizing some function or variable (risk, costs).\textsuperscript{12}

The researcher concludes the preliminary part of the study with the comments that corporate governance has wide ramifications and extends beyond good corporate performance and financial propriety, though these are no doubt essential. If we look at corporate governance as merely generating profits and discharging of responsibilities towards shareholders, employees, customers and suppliers, several corporates would meet the test.

However, despite meeting the above tests, corporate have been guilty of transgression of laws and diversion of funds into risky ventures which failed to yield results. Therefore, corporate governance means the total functioning of the company and the conduct of business internally and externally and embraces the complete accountability of the management and the Board of Directors to the shareholders and the wider public.

\textsuperscript{12} Seshiah K: Business Values & Ethics, New Delhi, 2004.