CHAPTER - III
CORPORATE SOCIAL RESPONSIBILITY AND ITS RELATIONSHIP WITH CORPORATE GOVERNANCE AND SUSTAINABLE DEVELOPMENT

3.1 Introduction

Governance is an issue which has come to the fore recently as a direct cause of problems associated with the financial and economic crisis. This applies to governance in general but to corporate governance in particular. Corporate governance can be considered as an environment of trust, ethics, moral values and confidence as a synergic effort of all the constituents of society that is the stakeholders including government, the general public and so on, professionals / service providers and the corporate sector. Corporate governance is a current buzzword the world over. It has gained tremendous importance in recent years. Two of the main reasons for this upsurge in interest are the economic liberalization & deregulation of industry & business and the demand for new corporate ethos & stricter compliance with the law of the land. One more factor that has been responsible for the sudden exposure of the corporate sector to a new paradigm for corporate governance, is in tune with the changing times that is the demand for greater accountability of companies to their shareholders and customers.¹

Good governance is essential for good corporate performance and one view of good corporate performance is that of stewardship and thus, just as the management of an

organization is concerned with the stewardship of the financial resources of the organization so too would management of the organization be concerned with the stewardship of environmental resources. The difference, however, is that the environmental resources are mostly located externally to the organization. Stewardship in this context, therefore, is concerned with the resources of society as well as the resources of the organization. As far as stewardship of external environmental resources is concerned then the central tenet of such stewardship is that of ensuring sustainability. 2

Sustainability is focused on the future and is concerned with ensuring that the choices of resource utilization in the future date are not constrained by decisions taken in the present. This necessarily implies such concepts as generating and utilizing renewable resources, minimizing pollution and using new techniques of manufacture and distribution. It also implies the acceptance of any costs involved in the present as an investment for the future.

3.2 Genesis of Need for Corporate Governance

3.2.1 Globalization and Free Market

Two features describe the modern world- Globalization and the free market. It is duly accepted almost unquestioningly that free markets will lead to greater economic growth and that we will all benefit from this economic growth. Around the world, people especially politicians and business leaders are arguing that restrictions upon world economic activity caused by the

2 Guler Aras and David Crowther; A Handbook of Corporate Social Responsibility, Gower, 2010, P. 3.
regulation of markets are bad for our well-being. And in one country after another, for one market after another, governments are capitulating and ‘relaxing their regulations to allow complete freedom of economic activity. So the world is rapidly becoming a global market place for global corporations, increasingly unfettered by regulation. But the ill effect of the actions of some of these corporations within the United States itself has projected the adverse picture. The global accounting firm Anderson collapsed; Major corporations such as Enron and World.com went bankrupt with thousands of people being thrown out of work and many people lost the savings for their old age for which they have worked so long and hard to gain. The sub prime crisis of U.S. and Euro zone crisis in Europe and Satyam saga of India are the latest examples of poor or rather corrupt/ unethical corporate governance.

One way to describe why this has happened is to acknowledge that there are problems with accounting, with auditing, and with peoples’ expectations. The regulatory regime of accounting has been increasingly changed over time to serve the interests of businesses rather than their owners or society.

Thus it is no longer expected that the accounting of a business should be undertaken conservatively by recognizing potential future liabilities while at the same time not recognizing future profit. Instead profit can be brought forward into the accounts before it has been earned while liabilities (such as the replacement of an aging electricity distribution network) can be ignored, if, they reduce current profitability. A study of the changes made in accounting standards over the years shows a gradual relaxation of this requirement for conservatism in
accounting as these standards have been changed to allow firms to show increased profits in the present. This of course makes the need for strong governance procedures even more paramount.

3.2.2 Growing size and influence of Corporate

Need for good Corporate Governance is ancient, fair and transparent regulation of corporations is increasingly important. The unprecedented size and geographical scope of today’s large corporations has created entities profits exceed the GDPs of many smaller countries. Wal-Mart and the larger oil related corporations such as Exxon, Royal Dutch Shell, BP and General Motors, achieve annual profits in the region of US$10 to 40 billion. The total revenues of the world’s 12 largest corporations in 2007, US$ 2.8 trillion, are comparable to the GDP of Germany and exceed the GDP of China or the UK. Accountants talk of corporate profits as the ‘bottom line’; as if that were the financial conclusion. In GAAP³ terms it may be; in societal terms there are many lines below. Who gets these profits, how are they distributed, how, if at all, are losers from corporate activities compensated? Without a distribution framework, the large companies of the twenty-first century may become not so much generators as concentrators of economic wealth. That could lead to a loss of legitimacy of the corporation, a damaging prospect for all, investors included, even when things are going right for the business. When things go wrong they may do so on an appalling scale. The Union Carbide explosion at Bhopal is often

³ Generally accepted accounting principles (GAAP) refer to the standard framework of guidelines for financial accounting used in any given jurisdiction; generally known as accounting standards or standard accounting practice. These include the standards, conventions, and rules that accountants follow in recording and summarizing and in the preparation of financial statements. (Source: Wikipedia).
cited as the world’s worst industrial accident; the total death toll came to 15,000, and a further 120,000 continue to live with the effects of gas poisoning.⁴

3.2.3 Scope of Corporate Governance

Economists, especially of the neo-liberal persuasion, may define corporate governance narrowly as ‘being concerned with the institutions that influence how business corporations allocate resources and returns’, or more widely as ‘a set of relationships between a company’s board, its shareholders, and other stakeholders’. From this perspective, the purpose of a business is solely to make money for its owners. The actions of a company, will inevitably affect a much wider range of actors. These include national governments, other companies, the managers and employees, the suppliers and customers of that business, and through the externalities they may suffer at the hands of a corporation, the general public also. A wider definition of corporate governance was offered by Sir Adrian Cadbury. He is quoted in ‘Global Corporate Governance Forum’, World Bank 2000, as stating, ‘Corporate Governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The corporate governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations, and society.”

Probably since the mid-1980s, corporate governance has attracted a great deal of attention. The early impetus was

⁴ Hillary Shaw; A Handbook of Corporate Governance & Corporate Social Responsibility, Gower, 2010, PP. 191-192.
provided by Anglo-American codes of good corporate governance. Stimulated by institutional investors, many other countries in the developed, as well as in emerging markets, established or adapted versions of these codes for their own companies. Supra-national authorities like the OECD and the World Bank did not remain passive and developed their own set of standard principles, and recommendations. This type of self-regulation was chosen above a set of legal standards. After the recent big corporate scandals the formalization of corporate governance has become central to most companies. It is understandable that investors’ protection has become a much more important issue for all financial markets after the tremendous, high-profile firm failures and scandals.

Investors are demanding that companies implement rigorous corporate governance principles in order to achieve better returns on their investment and to reduce agency costs. Most of the time investors are ready to pay more for companies to have good governance standards. Similarly a company’s corporate governance report is one of the main tools for investors’ decisions. Because of these reasons companies cannot ignore the pressure for good governance from shareholders, potential investors and other markets actors.

3.2.4 Principles of Corporate Governance

Since corporate governance can be highly influential for firm performance, firms must know what the corporate governance principles are and how it will improve strategy to apply these principles. In practice there are four principles of good corporate governance, which are:
All these principles are related with the firm’s corporate social responsibility. Corporate governance principles therefore are important for a firm but the real issue is concerned with what corporate governance actually is. Management can be interpreted as managing a firm for the purpose of creating and maintaining value for shareholders. Corporate governance procedures determine every aspect of the role for management of the firm and try to keep in balance and to develop control mechanisms in order to increase both shareholder value and the satisfaction of other stakeholders. In other words, corporate governance is concerned with creating a balance between the economic and social goals of a company including such aspects as the efficient use of resources, accountability in the use of its power and the behavior of the corporation in its social environment.  

The definition and measurement of good corporate governance is still subject to debate. However, good corporate governance will address such points as creating sustainable value, achieving the firm’s goals and keeping a balance between economic and social benefit. Also, of course, good governance offers some long-term benefits for a firm, such as reducing risk and attracting new investors, shareholders and more equity.

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3.3 Various theories related to corporate governance

‘The directors of companies, being managers of other people’s money than their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in a private company frequently watch over their own’.\(^6\) This statement clearly describes the apprehensions of the shareholders when they select the directors and entrust upon them the responsibility to ensure regular higher returns on their investment. Therefore, there are a few theories related to corporate governance that try to resolve the problem of separation of ownership and control:\(^7\)

- Agency theory
- Stewardship theory
- Shareholder versus stakeholder theory
- Transaction cost theory
- Sociological theory

3.3.1 Agency Theory

The agency theory describes the economic relationship that arises between two individuals, one being the principal and the other being the agent. In a corporate scenario, the principal stockholders/ shareholders are the principal and the directors/ managers are the agents.

The major issue with the numerically growing and geographically dispersed shareholders is the lack of transparency,


\(^7\) Madhumita Chatterji; Corporate Social Responsibility, Oxford University Press, 2011, P. 44
and therefore the control is also dispersed and less effective. This has led to over-dependence on the directors to act honestly, keeping the shareholders’ interest in mind.

With the growing complexity of business, tracing the agency chain becomes difficult, especially when investment is routed through various financial instruments/funds like bonds, equities, commodities, hedge funds, etc. Agency loss can occur in any form of a corporation. This loss was discovered by Jensen and Meckling\(^8\) when they wrote ‘agency theory involves a contract under which one or more persons (the shareholders) engage another person (director) to perform some service on their behalf, which includes delegating some decision making authority to the agent. If both parties to the relationship are utility maximizers, there is a good reason to believe that the agent will not always act in the best interest of the principal?’

3.3.2 Stewardship Theory

This theory is built on the premise that the directors will fulfill their fiduciary duties to the shareholders. It assumes that human beings by nature are good and therefore directors are basically trustworthy. Personal reputation holds a very significant place in the directors/managers behavior; hence they would not indulge in any activity that could damage their self-respect. This theory centers on the situations in which directors are stewards whose motives are aligned with the objectives of their principals.

Directors need to take into account the well-being of all the stakeholders of the organization, since they are serving as

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stewards, but under the law their first responsibility is to the shareholders. This is where governance has to incorporate corporate social responsibility. It is believed that the control of the stewards through rules can be detrimental because it undermines the pro-organizational behavior of the steward by lowering his/her motivation. In fact, the trust reposed on the directors underpins company laws and governance codes.

### 3.3.3 Shareholder and Stakeholder Theory

Shareholder approaches argue that corporations have limited duties/responsibilities, i.e., obeying the law and maximizing shareholder wealth. The stakeholder theory is grounded in many normative, theoretical perspectives including the ethics of care, the ethics of fiduciary relationships, the social contract theory, the theory of property rights, and so on. All these theories deal with practical moral concerns and define what should be the way of achieving ethical relationship among stakeholders of business. Companies need to honour the trust that society places on them. With the growth of mammoth organizations, the impact on all aspects of human interaction is unquestionable. The inclusion of all constituents like shareholders, employees, customers, suppliers, bankers, partners in supply chains, community, environment, government, and nongovernmental organizations is demanded under this theory.

With the collapse of a large number of corporations, the magic of the market has been challenged and there is a strong movement towards social responsibility and sustainability in the business world. Millstein and Katsch (1981) have opined that ‘this strident and partisan concept of substantially unrestrained corporate power and discretion is, in a more moderate form,
among the most important fundamental public concerns within large corporations ... as issue is whether the nation ... will accept larger private corporate size, accelerate the decline of pluralism by regulating or by giving greater responsibility to government, or by requiring fundamental changes in the internal governance structure of our major corporations.'

The stakeholder theory is more broad-based and takes into account the needs of all the parties that are affected by business, either directly or indirectly. It is more fair and just in terms of sharing the benefits that accrue to business.

3.3.4 Transaction Cost Theory

Stiles and Taylor⁹ explained that ‘both transaction cost economics and agency theories are concerned with managerial discretion and both assume that managers are given to opportunism (self-interest seeking) and moral hazard, and those managers operate under bounded rationality.’ This theory is similar to the agency theory as it also discusses how managers may be selfishly driven to undertake transactions that benefit them personally, more than the company. They may also take transaction decisions without much study, as the money invested is not their personal money, and therefore, those deals may not yield the expected profits for the shareholders. Therefore, to avoid such losses, transaction cost economics is entirely dependent on the mechanisms of internal and external controls like audit control, separation of board chairmanship from CEO, information disclosure, and non-executive independent directors.

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3.3.5 The Sociological Theory

The theory has focused mostly on broad compositions and wealth distribution. Under this theory, the composition of the board, transparency of financial reporting, disclosure, and auditing are considered central to realizing the socio-economic objectives of corporations.

3.4 Relation of Corporate Social Responsibility with Corporate Governance and Sustainable Development

It is clearly accepted that good corporate governance is fundamental to the success of any corporation; hence much attention has been paid to the procedures of Governance. Often, however, what is actually meant by the corporate governance is merely assumed without being made explicit; moreover it is assumed that the concept is simply connected to the management of investor relationships. Similarly the Corporate social responsibility is generally accepted to be fundamental in continuing of any corporation.

For these two such important aspects there have to be a relationship between the two, although little work has been undertaken on exploring this relationship. But after analysing the definitions it seems that the two concepts are inextricably linked and that it is necessary to take a broader view of corporate governance which encompasses relationship with the whole stakeholder community and necessarily therefore incorporates the principles of Corporate Social Responsibility.10

Good governance is, of course, important in every sphere of

the society whether it be the corporate environment or general society or the political environment. Good governance levels can, for example, improve public faith and confidence in the political environment. When the resources are too-limited to meet the minimum expectations of the people, it is a good governance level that can help to promote the welfare of society. And of course a concern with governance is at least as prevalent in the corporate world.\textsuperscript{11} It is off course no longer questioned that the activities of a corporation impact upon the external environment and that therefore such an organization should be accountable to a wider audience than simply its shareholders. This is a central tenet of both the concept of corporate governance and the concept of CSR. Implicit in this is a concern with the effects of the actions of an organization on its external environment, and there is recognition that it is not just the owners of the organization who are concerned with the activities of that organisation. Additionally there are a wide variety of other stakeholders who justifiably, are concerned with those activities, and are affected by those activities. Those other stakeholders have not just an interest in the activities of the firm but also a degree of influence over the shaping of those activities, this influence is so significant that it can be argued that the power and influence of these stakeholders is such that it amounts to quasi-ownership of the organisation.

One view of good corporate performance is that of stewardship and thus, just as the management of an organisation is concerned with the stewardship of the financial resources of

\textsuperscript{11} Durnev A & Kim E. H; To Steal or Not to Steal: Firm Attributes, Legal Environment, and Valuation; Journal of Finance, LX (3), PP. 1461-1493.
the organisation so too would management of the organisation be concerned with the stewardship of environmental resources with the resources of society as well as the resources of the organisation.\textsuperscript{12}

The difference, however, is that environmental resources are mostly located externally to the organization. Stewardship in this context, therefore, is concerned with the resources of society as well as the resources of the organisation. As far as stewardship of external environmental resources is concerned, then the central tenet of such stewardship is that of surfing sustainability. Sustainability is focused on the future and is concerned with the choices of resource utilization in the future are not constrained by decisions taken in the present. This necessarily implies such concepts as generating and utilizing renewable resources, minimizing pollution and using new techniques of manufacture and distribution. It also implies the acceptance of any costs involved in the present as an investment for the future. The sustainable activities not only impact society in the future but also impacts upon the organisation itself in the future. Thus good environmental performance by an organisation in the present is in reality an investment in the future of the organisation itself. This is achieved through the ensuring of supplies and production techniques which will enable the organisation to operate in the future in a similar way to its operations in the present and so to undertake value creation activity in the future much as it does in the present. Financial management also, however, is concerned with the management of the organization’s resources in the

\textsuperscript{12} Aras and Crowther D: The Durable Corporation: Strategies for Sustainable Development; Aldershot; Gower, 2009.
present so that management will be possible in a value creation way in the future. Thus the internal management of the firm, from a financial perspective, and its external environmental management coincide in this common concern for management for the future. Good performance in the financial dimension leads to good future performance in the environmental dimension and vice versa. Thus there is no dichotomy between environmental performance and financial performance and the two concepts conflate into one concern. This concern is, of course, the management of the future as far as the firm is concerned.

Similarly the creation of value within the firm is followed by the distribution of value to the stakeholders of that firm, whether these stakeholders are shareholders or others. Value, however, must be taken in its widest definition to include more than economic value as it is possible that economic value can be created at the expense of other constituent components of welfare such as spiritual or emotional welfare. This creation of value by the firm adds to welfare for society at large, although this welfare is targeted at particular members of society rather than treating all as equals. This has led to “arguments concerning the distribution of value created and whether value is created for one set of stakeholders at the expense of others. Nevertheless if, when summed, value is created, then this adds to welfare for society at large. Mainly good environmental performance leads to increased welfare for society at large, although this will tend to be expressed in emotional and community terms rather than being capable of being expressed in quantitative terms. This will be expressed in a being of well-being, which will, of course, lead to increased motivation. Such increased motivation will inevitably
lead to increased productivity, some of which will benefit the organizations and also a desire to maintain the pleasant environment which will in turn contribute to a further enhanced environment, a further increase in welfare and the reduction in destructive aspects of societal engagement by individuals.

3.4.1 CSR is Gaining More Prominence Probably due to More Awareness

There has been considerable debate about the relationship between corporate social responsibility and corporate governance but in recent years the term corporate social responsibility has gained prominence, both in business and in the press to such an extent that it seems to have become ubiquitous. There are probably many reasons for the attention given to this phenomenon, not least of which is the corporate excesses witnessed in recent years. For many people the various examples of this kind of behavior ranging from ECCI to Enron to Union Carbide to the collapse of Arthur Andersen, will have left an indelible impression among people that all is not well with the corporate world and that there are problems which need to be addressed.\textsuperscript{13}

Issues of socially responsible behavior are not new and examples can be found from throughout the world and at least from the earliest days of the Industrial Revolution and the concomitant founding of large business entities and the divorce between ownership and management or the divorcing of risk from rewards.\textsuperscript{14} Thus, for example in the UK (where the Industrial

\textsuperscript{13} Aras G & Crowther D: Exploring Framework of Corporate Governance, Leicester; SRR Net; 2008, PP. 3-16.

Revolution started), Robert Owen (1816) demonstrated dissatisfaction with the assumption that only the internal effects of actions need be considered and the external environment was a free resource to be exploited at will. Furthermore, he put his beliefs into practice through the inclusion within his sphere of industrial operations the provision of housing for his workers at New Lanark, Scotland. Thus there is evidence from throughout the history of modernity that the self-centered approach towards organizational activity was not universally acceptable and was unable to satisfactorily provide a basis for human activity. Since that time there has been a concern for the socially responsible behavior of organizations which has gained prominence at certain times while being considered of importance at others. 15

Definitions of CSR abound but all can be seen as an attempt to explain and define the relationship between a corporation and its stakeholders, including its relationship with society as a whole. Many too are phrased in terms of the triple bottom line, in a way which, we argue, trivializes the concept. Because of the uncertainty surrounding the nature of CSR activity it is difficult to evaluate any such activity. It is therefore imperative to be able to identify such activity and Aras & Crowther argue that there are three basic principles which together comprise all CSR activity. 16 These are:

- Sustainability
- Accountability
- transparency

16 Aras & Crowther; Sustainable Corporate Social Responsibility and the Value Chain, MARA University Press, PP. 119-140.
For a few years now the concept of CSR has gained prominence and is gaining increasing attention around the world among business people, media people and academics from a wide range of disciplines.

There are probably many reasons for the attention given to this phenomenon, not least of which is the corporate excesses which continue to become manifest in various parts of the world. These have left an indelible impression among people that all is not well with the corporate world and that there are problems which need to be addressed. Such incidents are too common to recount but have left the financial markets in a state of uncertainty and have left ordinary people to wonder if such a thing as honesty exists any longer in business. More recently, the language used in business has mutated again and the concept of CSR is being replaced by the language of sustainability.

3.4.2 Conflicts between CSR & Corporate Governance

Conflicts over the exact scope of CSR and of corporate governance may therefore arise over several dimensions:

- over time, as booms and busts in the economy make CSR more or less profitable;
- over space, as a broader definition of ‘stakeholders’ conflicts with the need to focus production in least-cost regions;
- over the agency framework, as different agencies/actors offer competing definitions of the true scope of shareholder-funded CSR; and
- over competing philosophical perspectives as to what is the true function of a company and what constitutes ethical use of its owner’s money.
Moral conflicts may also arise, especially for those who maintain a wider definition of corporate governance and CSR. By 1998 all legal liabilities arising from the Bhopal tragedy were wound up, and in 2001 the Dow Corporation bought Union Carbide, having checked on the legal situation. Yet many Indians have ongoing severe disabilities arising from Bhopal Gas Disaster. The question was does the Dow Corporation have a moral responsibility towards these victims? If so, what about their families, their dependants, in a land with rudimentary State support for those who cannot work? There are companies still trading today that traded with the Nazis in the 1930s and 40s, although directorships, employees and shareholder ownership have changed, perhaps many times, since then. Does any liability remain to compensate descendants of the (uncompensated) victims of the Nazi regime? Corporations are theoretically immortal, and this is the disadvantages of immortality.

3.4.3 Corporate Social Responsibility and Sustainable Development

In 1987, the World Commission on Environment and Development (WCED)\textsuperscript{17}, which had been set up in 1983, published a report entitled Our Common Future. The document came to be known as the Brundtland report after the Commission’s Chairwoman, Harlem Brundtland, and the then Prime Minister of Norway. This document developed guiding principles for sustainable development as it is generally understood today.\textsuperscript{18}

\textsuperscript{17} The Commission was established to make available a report on environment and the global problématique to the year 2000 and beyond, including proposed strategies for sustainable development.

\textsuperscript{18} Sanjay K. Aggarwal; Corporate Social Responsibility in India, Response Books, 2008, PP. 64-65.
Sustainable development is defined as ‘development that meets the needs of the present without compromising the ability of future generations to meet their own needs’. The word ‘sustainable’ itself means something that lasts long while ‘development’ implies a change that is considered desirable in a society. It involves socio-economic change leading to improvement in the conditions of life. The Brundtland Report stated that the critical global environmental problems were primarily the results of the enormous poverty in the South and the non-sustainable patterns of consumption and production in the North. It called for a strategy that would combine development and environment, described by the now commonly used term ‘Sustainable Development’.

Figure 3.1 Sustainable development within and across the three societal domains
Source: Reinhard Steurer, The role of government in CSR: Characterizing Public Policies on CSR in Europe, Discussion Paper 2-2010, p. 4

Formally known as the World Commission on Environment and Development (WCED), the Brundtland Commission's mission is to unite countries to pursue sustainable development together. Brundtland Commission officially dissolved in December 1987 after releasing the Brundtland Report, also known as Our Common Future.
The report highlighted the environmental and development issues, which are being faced by the world as one common challenge, to be solved by collective multilateral action rather than through the pursuit of national self interest. The report made institutional and legal recommendations in order to confront common global problems. Critical amongst these recommendations is the call for the development and expansion of international institutions for mutual cooperation, and the setting up of legal mechanisms to confront common concerns. The report effectively called for international action on issues of common concerns and also for increasing cooperation with industry. The Burndtland Commission’s key concept for sustainability envisaged that ‘today’s needs should not compromise the ability of future generations to meet their needs’ and ‘in all our actions, we must consider the impact upon future generations’.

In 1989, the report was debated in the UN General Assembly, which decided to organise a UN Conference on Environment and Development. Tangible results have flown from the Burndtland Report, such as the emergence of international agreements like the Montreal and Kyoto Protocols, Agenda 21 etc., which have further enshrined the concept of environmentally sustainable development.

3.4.4 Sustainable Development by Way of Environment Protection

International efforts towards environment protection have their roots in the United Nations Environment Programme (UNEP)\textsuperscript{20}, which was established in 1972 after the UN Conference

\textsuperscript{20} The United Nations Environment Programme (UNEP) is an international institution (a programme, rather than an agency of the UN) that coordinates United Nations environmental activities, assisting developing countries in implementing environmentally sound policies and
Since 1972, the United Nations Conference on the Human Environment was held. Since then, it has done a remarkable job starting with the ‘Convention on International Trade in Endangered Species of Wild Fauna and Flora’ held in 1973, moving to the Vienna Convention for the Protection of the Ozone Layer in 1985, and so on. UNEP hosts several environmental convention secretariats including the Ozone Secretariat, the multilateral fund of the Montreal Protocol, the Convention on Biological Diversities (CBD), the Stockholm Convention on Persistent Organic Pollutants (POPs), etc.

The area of operations of UNEP extends to assessment of global, regional and national environmental conditions and trends, development of international agreements and national environmental instruments, strengthening of institutions for the wise management of the environment, integration of economic development and environmental protection, facilitation of the transfer of knowledge and technology for sustainable development, and providing encouragement to new partnerships and mindsets within civil societies and the private sector.

3.4.5 Agenda 21, the Action Plan for Sustainable Development

During 3-14 June 1992, the United Nations held a Conference on Environment and Development (The Earth Summit) in Rio de Janeiro, Brazil, where the nations of the world agreed on an action plan for sustainable development for the next century.

practices. It was founded as a result of the United Nations Conference on the Human Environment in June 1972.

21 The United Nations Conference on Environment and Development (UNCED), also known as the Rio Summit, Rio Conference, and Earth Summit was a major United Nations conference held in Rio de Janeiro from 3 June to 14 June 1992. The Earth Summit resulted in the following documents: Rio Declaration on Environment and Development; Agenda 21; Forest Principles.
This action plan, known as Agenda 21, recognises that:

(a) Humans depend on the earth to sustain life.

(b) There are linkages between human activity and environmental issues.

(c) Global concerns require local actions.

(d) People have to be involved in planning developments for their own if such developments are to be sustainable.

Agenda 21 is a comprehensive plan of action to be undertaken globally, nationally and locally by organisations of the United Nation Systems, governments and major groups in every area in which human impacts on the environment.

The action plan includes the issues of:

(a) Combating of poverty;

(b) Changing consumption patterns;

(c) Demographics and sustainability;

(d) Protection of human health;

(e) Human settlements;

(f) Integration of the environment and development in decision-making;

(g) Protection of the atmosphere;

(h) Planning and management of land resources;

(i) Combating of deforestation;

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Agenda 21 is a non-binding, voluntarily implemented action plan of the United Nations with regard to sustainable development. It is a product of the UN Conference on Environment and Development (UNCED) held in Rio de Janeiro, Brazil, in 1992. It is an action agenda for the UN, other multilateral organizations, and individual governments around the world that can be executed at local, national, and global levels. The "21" in Agenda 21 refers to the 21st century. It has been affirmed and modified at subsequent UN conferences.
(j) Desertification and drought;
(k) Sustainable mountain development;
(l) Sustainable agriculture;
(m) Conservation of biological diversity;
(n) Management of biotechnology;
(o) Protection of the oceans;
(p) Management and use of water resources;
(q) Management of toxic chemicals;
(r) Management of hazardous wastes;
(s) Management of solid wastes;
(t) Management of radioactive wastes;
(u) Global action for women;
(v) Role of children and youth in sustainable development;
(w) Role of NGO partners;
(x) Strengthening of workers and trade unions;
(y) Role of business and industry; and
(z) Role of farmers.

Agenda 21 has been the basis for action by many national and local governments. Over 150 countries have set-up National Advisory Councils to promote dialogue between governments, environmentalists, the private sector and the general community. Many have also established programmes for monitoring national progress on sustainable development indicators. Nearly 2,000 cities and towns worldwide have created their own local Agenda 21 plans. Now these type of mechanism basically force corporate to behave responsibly and ensure environment protection.
3.4.6 Triple Bottom Line principles of Sustainable Development and CSR

The term ‘Triple Bottom Line’ has its origin in the concept of sustainable development. In recent years, the business case for CSR has been gaining ground, revolving around the idea that what is good for the environment, the workers and the community is also good for the financial performance of the business. It is often described as ‘performance with a purpose’. CSR is closely linked with the principles of sustainable development, according to which companies should be obliged to make decisions based not only on financial/economic factors but also on the social, environmental and other consequences of their activities. Triple Bottom Line’ (TBL) takes in its fold the following three parameters to gauge business performance, i.e.

(a) Economic;  
(b) Environmental; and  
(c) Social Factors.

The term ‘Triple Bottom Line’ was coined by Sustainability Limited\(^{23}\), an international business consultancy, founded in 1987, headquartered at London with offices in Europe and the United States, and with a network of partnerships around the world, particularly in the emerging economies of China, South Africa, Brazil and India.

According to Sustainability, ‘The Triple Bottom Line focuses corporations not just on the economic value they add, but

\(^{23}\) [www.sustainability.com](http://www.sustainability.com)
also on the environmental and social value they add and destroy.
At its narrowest, the term ‘Triple Bottom Line’ is used as a framework for measuring and reporting corporate performance against economic, social and environmental parameters. At its broadest, the term is used to capture the whole set of values, issues and processes that companies must address in order to minimize any harm resulting from their activities and to create economic, social and environmental value. This involves being clear about the company’s purpose and taking into consideration the needs of all the company’s stakeholders—shareholders, customers, employees, business partners, governments, local communities and the public’. Triple Bottom Line is also defined as an evaluation of a business enterprise by comprehensively assessing its financial, environmental and social performance. TBL provides a framework within which corporate performance and social responsibilities are measured and evaluated.

A newer concept, far superior to the TBL concept, called ‘Triple Green Rating’ is slowly emerging.24 Triple Green Rating involves three parameters, i.e.:

(a) Being water-positive;
(b) Being carbon-positive; and
(c) Having zero solid waste.

3.4.7 Equator principles of Sustainable Development

Forty-four top international banks and financial institutions have subscribed to the ‘Equator Principles’. They were evolved

when International Finance Corporation (IFC)\(^{25}\) convened a meeting of banks in London in October 2002 to discuss environmental and social issues in project finance. These principles, evolved in 2003, were revised in 2006.\(^{26}\) By adopting the Equator Principles, these banks and institutions seek to ensure that infrastructure projects being financed by them reflect socially responsible and environmentally sound practices.

The principles apply to the financing of all new projects with total capital costs of USD 10 million or more across all industry sectors globally. These will apply to financing of all projects covering the expansion or upgradation of an existing project where changes in project scale or scope create significant additional environmental and/or social impacts, or significantly change the nature or degree of its existing impact. The adoption of Equator Principles confirms that the role of global financial institutions is changing. More than ever before, people at the local level know that the environmental and social aspects of an investment can have profound consequences on their lives and communities, particularly in the emerging markets where regulatory regimes are often weak.

By adopting these principles, financiers undertake to:

(i) Review carefully all sponsors of project financing proposals, and

\(^{25}\) The International Finance Corporation (IFC) is an international financial institution which offers investment, advisory, and asset management services to encourage private sector development in developing countries. The IFC is a member of the World Bank Group and is headquartered in Washington, D.C., United States. It was established in 1956 as the private sector arm of the World Bank Group to advance economic development by investing in strictly for-profit and commercial projects which reduce poverty and promote development.

\(^{26}\) [www.equator-principles.com](http://www.equator-principles.com).
(ii) Refuse to provide loans to projects wherein the borrower is unable to comply with the prescribed environmental and social policies and processes. An important strength of the principles is the incorporation of covenants linked to compliance.

The borrower is required by covenant to:

(i) comply with all relevant local, state and host country social and environment laws, regulations and permits in all material respects; (ii) comply with the action plan (where applicable) during the construction and operation of the project in all material respects; (iii) provide regular reports (e.g., quarterly, semi-annually or annually), prepared by in-house staff or third party experts, on compliance with the action plan, and on compliance with relevant local, state and host country social and environment laws, regulations and permits; and (iv) decommission the facilities in accordance with an agreed decommissioning plan (where applicable). Each EPFI adopting the Equator Principles commits to periodically report publicly about its implementation processes and experience, taking into account appropriate confidentiality considerations.

3.5 Evidence of Relationship between CSR, Corporate Governance and Sustainable Development (Various initiatives)²⁷

In a more globalized, interconnected and competitive world, the way that environmental, social and corporate governance issues are managed is part of companies’ overall management

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quality needed to compete successfully. Companies that perform better with regard to these issues can increase shareholder value by, for example, properly managing risks, anticipating regulatory action or accessing new markets while at the same time contributing to the sustainable development of the societies in which they operate. Moreover these issues can have a strong impact on reputation and brands, an increasingly important part of company value. In this regard we are going to discuss the role of various Committees constituted on corporate governance in the coming paras.

3.5.1 Cadbury Committee, 1992

The Cadbury Committee investigated the accountability of the Board of Directors to the shareholder and to society. It has 19 recommendations in the nature of guidelines for the board of directors, executive directors, non-executive directors, and such other officials. Important recommendations include enhanced information to the shareholder and the setting up of the audit committee with independent members. Its model is one of self-regulation. The most controversial and revolutionary requirement was the Code of Best Practice proposed by the committee. It required that:

The directors should report on the effectiveness of a company’s system of internal control. The services of the directors should not extend beyond three years without the approval of the shareholders. Every listed company should create

29 The Cadbury Report, titled Financial Aspects of Corporate Governance, is a report issued by “The Committee on the Financial Aspects of Corporate Governance” chaired by Adrian Cadbury that sets out recommendations on the arrangement of company boards and accounting systems to mitigate corporate governance risks and failures.
an audit committee with a minimum of three non-executive directors. It was the extension of control beyond the financial matters that caused the controversy.

3.5.2 The Greenbury Committee, 1995

The committee was setup to provide an answer to the general concern about accountability and the directors’ remuneration. The committee believed in strengthening accountability by proper allocation of responsibilities for determining directors’ remuneration, accurate reporting to shareholders, and greater transparency in the process. The committee did not endorse statutory control for achieving the best practice. The Code of Best Practice devised by the committee was divided into four sections:

- Remuneration Committee;
- Disclosures;
- Remuneration Policy;
- Service contracts; Compensation.

All public limited companies were expected to produce annual compliance statements and encourage maximum implementation of the Code of Best Practice.

3.5.3 The Combined Code, 1998

The Combined code was basically derived from the Hampel Report, the Cadbury report, and the Greenbury report. The recommendations aimed at maintaining a sound system of

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30 The Greenbury Report released in 1995 was the product of a committee established by the United Kingdom Confederation of Business and Industry on corporate governance. It followed in the tradition of the Cadbury Report and addressed a growing concern about the level of director remuneration.

31 The Hampel Report (January 1998) in 1998 was designed to be a revision of the corporate governance system in the UK. The remit of the committee was to review the Code laid down by the Cadbury Report (now found in the Combined Code). It asked whether the code’s original purpose was being achieved. Hampel found that there was no need for a revolution in the UK corporate governance system. The Report aimed to combine, harmonise and clarify the Cadbury and Greenbury recommendations.
internal control to safeguard shareholders’ investment and company’s assets and to review at least annually the internal controls covering financial, operational, and compliance and risk management and report to shareholders that they have done so. Importance of risk management was highlighted as an important ingredient in the success of the corporate. It was mandatory for all listed companies to adhere to the combined code.

3.5.4 Sarbanes Oxley Act, 2002

The Sarbanes Oxley Act\(^\text{32}\) or SOX Act, 2002 is one of the most comprehensive Acts to control fraud and achieve quality governance. For the first time an Act tried to monitor minute details of organizational governance. It was aimed at protecting the investors and other stakeholders from corporate failures. Therefore, it provided detailed recommendations on various aspects:

1. Establishment of Public Company Accounting Board (PCAOB)
2. Audit Committee
3. Conflict of Interest
4. Audit Partner Rotation
5. Improper influence Prohibition of non-audit services
6. CEOs and CFOs required to affirm financials

\(^{32}\) It mandates that senior executives take individual responsibility for the accuracy and completeness of corporate financial reports. It defines the interaction of external auditors and corporate audit committees, and specifies the responsibility of corporate officers for the accuracy and validity of corporate financial reports. It enumerates specific limits on the behaviors of corporate officers and describes specific forfeitures of benefits and civil penalties for non-compliance. For example, Section 302 requires that the company's "principal officers" (typically the Chief Executive Officer and Chief Financial Officer) certify and approve the integrity of their company financial reports quarterly.
7. Loans to Directors
8. Attorneys
9. Securities Analysts
10. Penalties: Studies should be conducted by the Securities and Commission (SEC) or the Government Accounting Office in:
   (a) Auditor’s rotation
   (b) Off-balance sheet transactions
   (c) Consolidation of accounting firms and its impact on the accounting industry Exchange
   (d) Role of credit-rating agencies
   (e) Study of violators and violation during the years 1998-2001
   (f) SEC enforcement actions over the past five years
   (g) Role of investment banks and financial advisers
   (h) ‘Principle-based’ accounting on conduct of audits

3.5.5 Corporate Governance initiatives in India:

The Companies Act, 1956 provides for basic framework for regulation of all the companies. Certain provisions were incorporated in the Act itself to provide for checks and balances over the powers of Board viz.:

- Loan to directors or relatives or associated entities (need CG permission) (Sec 295).
• Interested contract needs Board resolution and to be entered in register (Sec 297).
• Interested directors not to participate or vote (Sec 300).
• Appointment of director or relatives for office or place of profit needs approval by shareholders.
• If the remuneration exceeds prescribed limit, CG approval required (Sec 314).
• Audit Committee for Public companies having paid-up capital of Rs. 5 Crores (Sec 292A).
• Shareholders holding 10% can appeal to Court in case of oppression or mismanagement (Sec. 397/398).

In Companies Act, 1956, SEBI has been given power only to administer provisions pertaining to issue and transfer of securities and non-payment of dividend. Apart from the basic provisions of the Companies Act, every listed company needs to comply with the provisions of the listing agreement as per Section 21 of Securities Contract Regulations Act, 1956. Non-compliance with the same, would lead to delisting under Section 22A or monetary penalties under Section 23 E of the said Act.33

Further, SEBI is empowered under Section 11 and Section 11A of SEBI Act to prescribe conditions for listing. However, Section 32 of the SEBI Act, 1992 states that the provisions of the SEBI Act, 1992 shall be in addition to, and not in derogation of, the provisions of any other law for the time being in force.34

Considering the emergence of code of best Corporate Governance practices all over the world (like Cadbury Greenbury

33 SEBI’s Consultative Paper n Review of Corporate Governance Norms in India, January, 2013
34 Ibid.
and Hampel Committee reports), in 1999, SEBI constituted a Committee on Corporate Governance under the Chairmanship of Shri Kumar Mangalam Birla, to promote and raise the standard of Corporate Governance in respect of listed companies. SEBI's Board, in its meeting held on January 25, 2000, considered the recommendations of the Committee and decided to make the amendments to the listing agreement on February 21, 2000 for incorporating the recommendations of the committee by inserting a new clause in the Equity Listing Agreement i.e. Clause 49.\(^35\)

Subsequently, after Enron, WorldCom, and other corporate governance catastrophes, SEBI felt that there was a need to improve further the level of corporate governance standards in India and constituted a second corporate governance committee chaired by Mr. Narayana Murthy, of Infosys Technologies Limited. Based on the recommendations of the aforesaid Committee, SEBI issued a circular on August 26, 2003 revising Clause 49 of the Listing Agreement. Based on the public comments received thereon and the revised recommendations of the Committee, certain provisions of the regulatory framework for corporate governance were modified and relevant amendments were made to Clause 49 of the Listing Agreement. The revised clause 49 superseded all the earlier circulars on the subject and became effective for listed companies from January 01, 2006. It is applicable to the entities seeking listing for the first time and for existing listed entities having a paid up share capital of Rs. 3 crores and above or net worth of Rs. 25 crores or more at any time in the history of the company.\(^36\)


\(^{36}\) Ibid.
3.5.6 SEBI’s Initiatives

SEBI appointed a committee on 7\textsuperscript{th} May, 1990 under the chairmanship of Kumara Mangalam Birla with a view to promoting and raising the standard of Corporate Governance. Mandatory recommendations:

1. **Applicability** - all listed companies with paid-up share capital of Rs 3 crore and above had to comply. Board of directors - Optimum combination of executive and non-executive directors was suggested. The number of independent directors should be at least one-third in case the company has a non-executive chairman and at least half of the board in case the company has an executive chairman.

2. **Independent directors** were those who, apart from receiving director’s remuneration, do not have any material pecuniary relationship or transaction with the company, its promoters, its management, or its subsidiaries, which in the judgment of the board, may affect the independent judgment of the directors.

3. **Audit committee** - Qualified and independent audit committee to enhance credibility and encourage transparency had to be created.

The audit committee should have a minimum of three members, all being non-executive directors with a majority being independent and at least one director having financial and accounting knowledge.

The audit committee should invite such executives as it considers appropriate, besides which the required head of internal audit and external audit representative should be present as
invitees for meetings of the committee.

The audit committee should meet at least thrice a year with a gap of not more than six months.

The quorum should be two members or one-third, whichever is higher, with a minimum of two independent directors.

As in the earlier recommendation, this committee also required confirmation that:

(a) The company will continue business in the course of the following year.
(b) The accounting policies and principles conform to standard practices.
(c) The management is responsible for the preparation, integrity, and fair presentation of financial statements and other information contained in the annual report.
(d) The chairman should be an independent director and must be present at the AGM to answer shareholder questions.

4. **Remuneration committee** of the board should decide the remuneration of the non-executive directors.

Full disclosure of the remuneration package of all the directors including salary benefits, bonuses, stock options, pension-fixed component, performance-linked incentives, along with the performance criteria, service contracts, notice period, severance fees, etc., should be made available in the section on Corporate Governance of the annual report.

5. **Board procedures**: The board meetings should be held at least four times a year with a maximum time-gap of four
months. Minimum information on annual operating plans and capital budgets, quarterly results, minutes of meeting of audit committee, and other committees, information on recruitment and remuneration of senior officers, significant labour problems, material default in financial obligations, statutory compliance, etc., should be placed before the board for its deliberation.

A director should not be member in more than ten committees and act as chairman of more than five committees across all companies in which he is a director.

6. **Management**: Management discussions and analysts report about industry structure, opportunities and threats, segment-wise or product-wise performance, risks, internal control systems, etc., are to form part of the director’s report or an addition to it.

The management must disclose to the board relating to all material, financial, and commercial transactions where they have personal interest that may have potential conflict with the interest of the company.

7. **Shareholders**: In case of a new director or re-appointment of existing director, information on resume, qualification, companies where he holds directorship and committee membership for shareholders’ perusal should be available. Sharing information of quarterly results on website for the benefit of shareholders.

A board committee under the chairmanship of a non-executive director should be created to look into redressing shareholder grievances.
For share transfer authority should be delegated to officer, committee, registrar, and share transfer agents to attend to issues at least once in a fortnight. Manner of Implementation: A separate section on Corporate Governance in annual reports is to be introduced.

In 2000 SEBI adopted the recommendation that the stock exchanges should modify the listing requirements by incorporating in them a new clause- Clause 49 so that disclosure is made in the following areas: board of directors; audit committee; remuneration of directors; board procedure; management; shareholders; report on corporate governance; compliance certificate from auditors.

SEBI’s Code of Corporate Governance requires that the following information by a company should be made available to the board of directors periodically:

(a) Annual operating plans and budgets and any updates
(b) Capital budgets and any updates
(c) Quarterly results for the company and its operating division or business segment.
(d) Minutes of audit committee meetings

37 Clause 49 of the SEBI guidelines on Corporate Governance as amended on 29 October 2004 has made major changes in the definition of independent directors, strengthening the responsibilities of audit committees, improving quality of financial disclosures, including those relating to related party transactions and proceeds from public/ rights/ preferential issues, requiring Boards to adopt formal code of conduct, requiring CEO/CFO certification of financial statements and for improving disclosures to shareholders. Certain non-mandatory clauses like whistle blower policy and restriction of the term of independent directors have also been included. The term ‘Clause 49’ refers to clause number 49 of the Listing Agreement between a company and the stock exchanges on which it is listed (the Listing Agreement is identical for all Indian stock exchanges, including the NSE and BSE). This clause is a recent addition to the Listing Agreement and was inserted as late as 2000 consequent to the recommendations of the Kumarmangalam Birla Committee on Corporate Governance constituted by the Securities Exchange Board of India (SEBI) in 1999.
(e) Information on recruitment and remuneration of senior officers just below the board level

(f) Material communications from government bodies

(g) Fatal or serious accidents, dangerous occurrences, or any material effluent pollution problems

(h) Details of any joint venture or collaboration agreement

(i) Labour relations

(j) Material transactions that are not in the ordinary course of business

(k) Disclosures by the management on material transactions, if any, with potential for conflict of interest

(l) Quarterly details of foreign exchange exposures and risk management strategies

(m) Compliance with all regulatory and statutory requirements.

3.5.7 Naresh Chandra Committee Report, 2002

Department of Company Affairs appointed the Naresh Chandra (NC) Committee.

Recommendations mainly concerned: (a) The auditor-company relationship; (b) disqualifications for audit assignments; (c) list of prohibited non-audit services; (d) independence standards for consulting; (a) compulsory audit partner rotation; (f) auditor’s disclosure of contingent liabilities; (g) auditor’s disclosure of qualifications and consequent action; (h) managements’ certification in the event of auditor’s replacement; (i) auditor’s annual certification of independence; (j) appointment of auditors; k) certification of annual audited accounts by the CEO and CFO; (l) auditing the auditors; (m)
setting up of the independent quality review board; (n) proposed disciplinary mechanism for auditors; (o) independent directors; (p) audit committee charter; (q) exempting non-executive directors from certain liabilities; (r) training of independent directors; (s) establishment of corporate serious fraud office and; (t) SEBI and subordinate legislation, etc.

The difference between the two committees: The NC Committee made no distinction between a board with an executive chairman or with the non-executive chairman. It has recommended that all boards should have at least half of its members as independent directors.

About audit committee, the KM Birla Committee suggested it should have non-executive directors as its members with at least two independent directors. The Naresh Chandra Committee was strict about the relationship between auditors and their clients.

The committee has recommended that along with its subsidiary, associates or affiliated entities, an audit firm should not derive more than 25 per cent of its business from a single corporate client. This move could affect small audit firms, because new firms which are usually small, may not be able to get business from a number of companies as they would have to establish their credentials in the market. Therefore, if it is regulated that not more than 25 per cent of business can be earned from one business, these small firms would never be able to establish themselves and would be taken over by bigger firms in the market who would continue to hold monopoly sway. This monopoly may become the breeding ground for corruption and ultimately impact the socio-economic structure of a country.
To ensure transparency, the proposal for compulsory rotation of audit firms was suggested. It stressed the partners and at least 50 per cent of the audit team working on the accounts of a company, need to be rotated by the audit firm once every five years. The NC Committee drew up a list of prohibited non-audit services.

It said nominees of institutions (FIs) cannot be counted as independent directors. The committee aimed at tightening the noose around the auditors by asking them to make an array of disclosures.

By calling upon the CEO and the CFO of listed companies to certify their company’s annual accounts it brought in accountability. It suggested setting up of quality review boards by the Institute of Chartered Accountants of India, Institute of Company Secretaries of India and the Institute of Cost and Works Accountants of India, instead of a public oversight board, as in the US. To attract quality independent directors, the committee recommended that these directors should be exempt from criminal and civil liabilities under the Companies Act, the Negotiable Instruments Act, the Provident Fund Act and the Employee State Insurance Act, the Factories Act, The Industrial Disputes Act, and the Electricity Supply Act.

3.5.8 The Narayana Murthy Committee Report, 2003

The terms of review were:

1. To review the performance of Corporate Governance.
2. To determine the role of companies in responding to rumour and other price-sensitive information circulating in the market in order to enhance the transparency and
integrity of the market.

The committee agreed with the NC Committee on:

- Disclosure of contingent liabilities
- Certification by CEOs and CFOs
- Definition of independent directors
- Independence of audit committees

3.5.8.1 Mandatory recommendation:

1. **Audit committee**: Should review
   
   (a) Financial statements and draft audit reports including quarterly and half-yearly information.
   
   (b) Management discussion and analysis of financial condition and the result of operations
   
   (c) Report relating to compliance with laws and risk management.
   
   (d) Management letters of internal control weaknesses issued by statutory internal auditors.

2. **Related party transactions**: A statement of all transactions with related parties including their bases should be placed before the audit committee.

3. **Proceeds from initial public offerings**: Companies raising money through IPO should disclose to the audit committee the uses and application under major heads on a quarterly basis. Each year the company shall prepare a statement of funds utilized for purposes other than those stated in offer document i.e. prospectus.

4. **Risk management**: Procedures to inform the board members of the risk assessment and minimization procedures. Management should place a report before the
entire board every quarter documenting the business risks faced by the company, measures to address and minimize such risks, and any limitation to the risk-taking capacity of the company. The board should formally approve this document.

5. **Code of conduct:** The code should be posted on the company’s website and all board members and senior management personnel shall affirm compliance with the code on an annual basis. The annual report of the company shall contain a declaration to this effect signed by the CEO and COO.

6. **Nominee directors:** Recommended removing the concept of nominee directors. Shareholders should appoint any director. And Institutional director, if appointed, would have the same responsibilities and liabilities as other directors.

7. Compensation to non-executive directors should be approved by the shareholders in the general meeting, restrictions were placed on grant of stock option, and it was required to make proper disclosures of compensation.

8. A whistle-blower policy was to be created in a company.

**3.5.8.2 Non-mandatory Recommendations**

Providing unqualified financial statements, training of board members, evaluation of non-executive directors’ performance by a peer group comprising the entire board of directors excluding the one being evaluated.
CII’s Recommendations,\textsuperscript{38} 1998

This body recommended

1. A single board can maximize long-term shareholder value. It should meet at least Six times a year, preferably at an interval of two months.

2. A listed company with a turnover of Rs 100 crores and above should have, professionally competent and recognized independent non-executive directors who should constitute: at least 30 per cent of the board if the chairman of the company is a non-executive director, or at least 50 per cent of the board if the chairman and MD is the same person.

3. A person should not hold directorship in more than ten listed companies which excluded directorship in subsidiary companies where over 50 per cent stake was held by the group company, and directorship in associate companies where more than 25 per cent but less than 50 per cent equity stake was held by the group company.

4. Non-executive directors should:
   
   (a) Become active participants in boards, not just passive advisors.

   (b) Have clearly defined responsibilities within the board, such as the audit committee.

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

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\textsuperscript{38} The Confederation of Indian Industry (CII) is a non-government, not-for-profit, industry-led and industry-managed organisation, seeking to play a proactive role in India’s development process. The organisation works to create and sustain an environment conducive to the growth of industry in India, partnering industry and government alike through advisory and consultative processes.
excludes those invited as experts in other fields such as science and technology.

5. To secure better efforts from non-executive directors companies should:

   (a) Pay a commission over and above the sitting fees for the user of the professional inputs. Commissions are rewards on current profits.

   (b) Consider offering stock options, so as to relate rewards to performance. Stock options are rewards contingent upon future appreciation of the corporate value.

6. While reappointing members of the board companies should give the attendance record of the concerned directors. If the director has not been present, i.e., absent with or without leave, for 50 per cent or more meetings, then this should be explicitly stated in the resolution that is put to vote. One should not reappoint such directors.

7. Key information that needs to be placed before the board must contain:

   (a) Annual operating plans and budgets as well as updated long-term plans, capital budgets, manpower, and overhead budgets.

   (b) Internal audit reports including cases of thefts and dishonesty of material nature show-cause, demand, and prosecution notices from revenue officers.

   (c) Fatal and serious accidents, dangerous occurrences, any effluent and pollution problems.

   (d) Default in payment of interest or non-payment of the
principal on any public deposit and/or any secured creditor or financial institution.

(e) Default such as non-payment of inter-corporate deposits by or to the company or materially substantial non-payments for goods sold by the company.

(f) Any issue that relates to public or product liability claim of a substantial nature.

(g) Details of any joint venture or collaboration agreement.

(h) Transactions that involve substantial payment towards goodwill, brand equity, or intellectual property.

(i) Recruitment and remuneration of senior officers just below the board level, including appointment or removal of the CFO and the Company Secretary.

(j) Labour problems and their proposed solutions.

(k) Quarterly details of foreign exchange exposure and the steps taken by management to limit the risks of adverse exchange rate movement.

8. For all companies with paid-up capital of Rs 20 crors or more, the quality and quantity of disclosure that accompanies a GDR issue should be the norm of any domestic issue.

Listed companies with either a turnover of Rs 100 crore or a paid up capital of Rs 20 crore, whichever is less, should appoint an Audit Committee within two years.

9. Under ‘Additional Shareholder’s Information’, listed companies give data on the following:
(a) High and low monthly averages of share prices in a major stock exchange where the company is listed for the reporting year

(b) Greater detail on business segments up to 10 per cent of turnover, giving a share in sales revenue, review of operations, analysis of markets, and future prospects

10. Companies that default on fixed deposits should not be permitted to accept further deposits and make inter-corporate loans or investments or declare dividends until the default is paid.

11. Major Indian Stock Exchanges should insist upon a compliance certificate signed by the CEO and the CFO, which should clearly state:

(a) The company will continue in business in the course of the following year

(b) The accounting policies and principles conform to the standard practice

(c) The management is responsible for the preparation, integrity, and fair presentation of financial statements and other information contained in the annual report

(d) The board has overseen the company’s system of internal accounting and administrative controls either directly or through its audit committee.

3.5.10 The Companies Bill, 2012

It may be noted that the Companies Bill, 2012 is passed by Lok Sabha. Though SEBI suggested that it should be given jurisdiction to prescribe matters relating to corporate governance for listed companies, it was decided by Ministry of Corporate
Affairs that core governing principles of corporate governance may be provided in the bill itself\textsuperscript{39}. Thus, in the Companies Bill 2012, various new provisions have been included (which are not provided for in the Companies Act, 1956) for better governance of the companies. Some of those new provisions are:

- Requirement to constitute Remuneration and nomination committee and Stakeholders Grievances Committee
- Granting of More powers to Audit Committee
- Specific clause pertaining to duties of directors
- Mode of appointment of Independent Directors and their tenure
- Code of Conduct for Independent Directors
- Rotation of Auditors and restriction on Auditor's for providing non-audit services
- Enhancement of liability of Auditors
- Disclosure and approval of RPTs
- Mandatory Auditing Standards
- Enabling Shareholders Associations/Group of Shareholders for taking class action suits and reimbursement of the expenses out of Investor Education and Protection Fund
- Constitution of National Financial Reporting Authority, an independent body to take action against the Auditors in case of professional mis-conduct
- Requirement to spend on CSR activities

\textsuperscript{39} SEBI’s Consultative Paper n Review of Corporate Governance Norms in India, January, 2013, P. 7.
The Companies Bill, 2012\textsuperscript{40} contains detailed provisions pertaining to corporate governance. Once the bill is enacted, the entire clause 49 may be revisited to make it consistent with the Companies Act. However, SEBI can impose more stringent conditions to the listed companies through listing agreement, than those proposed in the Companies Bill, considering the need to have better governance practices in the listed companies, provided those provisions are not derogatory to the provisions of the enactment.

It is clear that the definition of corporate governance has been considerably beyond investor relations and encompasses relations with all stakeholders including the environment. This is essential for the longer-term survival of a firm and is therefore a key component of sustainability. It is equally possible to state that a firm which has a more complete understanding of the relationship between social responsibility sustainability and corporate governance will address these issues more completely. By implication a more complete understanding of the inter-relationships will lead to better corporate governance, and therefore to better economic performance.

The corporate governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations, and society.” There is similar disagreement over the scope of CSR, and even of its relevance to business. The Confederation of British Industry stated, in 2001, that ‘CSR is

\textsuperscript{40} Bill No. 121-C of 2011, passed by Lok Sabha on 18\textsuperscript{th} December, 2012.
highly subjective and therefore does not allow for a universally applicable definition.’ However the Commission for the European Communities, also in 2001, defined CSR as, ‘a concept whereby companies integrate social and environmental concerns in the business operations and in their interactions with stakeholders on a voluntary basis. The obligation of a firm, beyond that required by law or economics, to pursue long term goals that are good for society.

The variance between the definitions is as instructive as the definitions themselves and serves to highlight the different agendas of the agencies involved. Ernst and Young (2002) notes the influence of investors, peer pressure, stakeholders and an internal ‘sense of social responsibility’ within the corporation, as agents promoting an increase in CSR as a regulatory factor in corporate governance. The identity and role of investors (shareholders) in a company is often clear, and corporations may well feel pressure, either from competitors (peer pressure) or from within the corporation (internal sense) to adopt a socially responsible form of governance. There is even an argument that firms should not be involved in CSR because this is using shareholders as means to a social end, not as ‘ends in their own right’. The contrary argument is that such social ends bring benefits back to the company and its owners.

Nevertheless a broad view of CSR can be profitable, according to recent data from the journal. This publication reports that 80 per cent of FTSE 100 companies now employ CSR directors, and that the UK market for ethical goods was worth

£24.7 billion in 2004 and growing at 15 per cent per annum. However building a CSR commitment with customers can be a long-term process, and in today’s fast changing and crowded advertising world that may not always appeal to the marketers. When a consumer spending downturn looms, corporations, especially large global corporations heavily reliant on economies of scale, may be tempted to re-focus on price cuts rather than quality and green issues. This was the route Tesco, Britain’s largest grocery retailer, appeared to be taking in 2007.  

So after analyzing all this literature we can conclude that there is deep relationship between CSR, Corporate Governance and Sustainable Development. Corporate Governance and sustainable development measure and mechanism leads to responsible corporate behavior. Corporate Governance and Sustainable Development are part of broader set of Corporate Social Responsibility.

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