PRIVATE & CONFIDENTIAL

HANDOUT

BUSINESS ETHICS &
CORPORATE GOVERNANCE

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BUSINESS ETHICS

Distinguishing:

• Ethics
• Ethics in Business
• Business Ethics
• Governance
• Corporate Governance
• Good Corporate Governance

In brief:

- Ethics: code of conduct for personal behaviour.
- Ethics in Business: Applying personal ethics into business.
- Business Ethics: Ethics of business, what is good & bad, right or wrong for business.
- Governance: Methods and practices of doing business in any organisation
- Corporate Governance: Set of practices business is carried on in corporate business organisation.
- **Good:** A code of best management Corporate practice which leads to Governance achievement of corporate mission.

Ethics – Definition

- Greek word “Ethos” – refers to character
- A code of conduct for personal behaviour
- Driving force – guide – value content
- A moral Code based on generally accepted standards
- Personal Ethics Vs. Ethics of Society

- Role of Ethics to discipline thoughts based on god and religion
- Role of law to regulate external behavior

Developing personal Code of Conduct

- For developing self-confidence/ personality/ Courage – Need to know what is Good' & 'Bad' for you
- For avoiding conflicts/ trauma and for achieving success
- Code should be built around your personal goals

Business Ethics

- It is Ethics **of** Business, study of what is good or bad, right & wrong, just & unjust, fair & unfair in the **business** as against in personal life.
- Code of conduct for businessman for carrying on business consistent with what others follows.
- Different from Personal Ethics.

Historical perspective of Business Ethics

- Historically, businessman was not respected for his ethical behaviour. Example of catholic Pope and businessman, going to Christian heaven where St. Peter – 423rd Pope – 1st Businessman to show up.
- Corporate Ethics Committee of 12 people - the ones did not get picked up in any important committees.

Buddha on Business Ethics

- Trader is like honey bee, sucks honey out of flower, without harm to flower

- Also helps flower pollinating – process of fertilisation – when taking profit, no harm to be done in quest of personal gain.
- Business Ethics is inseparable part of modern business
- It is vital for long term growth of business
- Manager's Ethics & Corporate Ethics are parts of Business Ethics.

Professional Manager

Ethical Manager:

- Ethics in Bhagwat Geeta: Krishna said "manager should look at the task set for him more for its satisfaction, the fulfillment that gives, rather than for personal gain or profit".

- Elliot Jacques, American scholar called professional manager as "Propertyless Manager", who manages the company successfully, but does not own any part of it as personal property. Does job not for personal gain, but for satisfaction he drives.

Objectives of Business Ethics

- Check malpractices - rapid business growth threw up many unethical practices – lust for money and economic power breeded many evils, which harmed society.
- Prevent exploitation of market, society and consumers.
- Drive home social responsibility to gain confidence of consumer – the king in competition.
- Forge cordial relation with the society.

Importance of Business Ethics

- Drive home that business is:

(i) not only for growth of businessman, also for long term growth of business itself,

(ii) long term creation of wealth,

(iii) creation of better social image, and

(iv) build investor confidence

Some principles of Business Ethics

- Take care of stakeholders, owners, employees, customers, suppliers, community and environment
- Fair dealings and fair practices in business
- Avoid exploitation of consumers
- Avoid profiteering
- Encourage healthy competition
- Accept social responsibility

Important issues in Business Ethics

- What is role of “profit” and “charity” in Business Ethics?
- Is “honesty” the best policy and good in the long run?
- Is there a difference between ethical/ unethical practices in “business” and in “personal life”?
- Do you agree that the business practice which is **legally sound** should be treated as **ethically sound** and some may not be **morally sound**?

What is Profit?

Business Ethics is not against Profit

The Profit is:

- Return on capital
- Reward for risk
- Plough-back for growth
- It is a driving force in business, but without exploiting market, consumers & other stakeholders

Business Ethics comprises:

i) Ethics of the Manager
ii) Corporate Ethics
iii) Industry Ethics

Corporate Ethics:

- Corporations develop their own code of ethics based on their mission and prevalent industry specific ethics.

- Such ethical framework provides strategic advantage over competitors, helps them achieve long terms business results in all the markets they operate.

WHAT IS CREDO?

- Codified ethical principles for carrying on business.

- Dictionary Meaning:

Webster International Dictionary:

"A strongly held or frequently affirmed belief or conviction; a generality or system adopted as a guide to action or achievement; tenet; doctrine".

Oxford Dictionary:

"A statement of belief; a creed"

RELEVANCE OF CREDO

- Credo will help corporations to face challenges of today and tomorrow and help them to stay on course and achieve their mission.
- Credo of Johnson & Johnson helped them to achieve their mission
- Corporate Mission of J&J –

'To be the best and the most competitive and comprehensive health care company in the world'.

Johnson & Johnson

has embodied its ethical principles
in their well known document
called "Our Credo"

<u>CREDO</u>

We believe our first responsibility is to the doctors, nurses and patients,
to mothers and fathers and all others who use our products and
services.

In meeting their needs everything we do must be of high quality.
We must constantly strive to reduce our costs
in order to maintain reasonable prices.
Customers' orders must be serviced promptly and accurately.
Our suppliers and distributors must have an opportunity
to make a fair profit.

We are responsible to our employees,
the men and women who work with us throughout the world.
Everyone must be considered as an individual.
We must respect their dignity and recognize their merit.
They must have a sense of security in their jobs.
Compensation must be fair and adequate,
and working conditions clean, orderly and safe.
We must be mindful of ways to help our employees fulfill
their family responsibilities.
Employees must feel free to make suggestions and complaints.
There must be equal opportunity for employment, development
and advancement for those qualified.
We must provide competent management,
and their actions must be just and ethical.

We are responsible to the communities in which we live and work
and to the world community as well.
We must be good citizens – support good works and charities
and bear our fair share of taxes.
We must encourage civic improvements and better health and education.
We must maintain in good order
the property we are privileged to use,
protecting the environment and natural resources.

Our final responsibility is to our stockholders.
Business must make a sound profit.
We must experiment with new ideas.
Research must be carried on, innovative programs
developed
and mistakes paid for.
New equipment must be purchased, new facilities provided
and new products launched.
Reserves must be created to provide for adverse times.
When we operate according to these principles,
the stockholders should realize a fair return.

Four Responsibilities

• Responsibility to Customers
• Responsibility to Employees
• Responsibility to Community
• Responsibility to Stockholders (Shareholders)

ANALYSIS OF EACH RESPONSIBILTY

Responsibility to Customers

- Produce high quality products and services.
- In order to maintain reasonable prices, be cost conscious in everything we do to reduce the prices.
- Constantly strive to provide value for money in our products and services.

- Give an opportunity to our suppliers and distributors to make a fair profit.
- Servicing our customers' orders promptly and accurately.

Responsibility to Employees

•Each one to be considered as individual by respecting hi/her dignity.

•Recognize the merit of the individual and provide opportunity for promotion/ advancement.

•Provide clean and safe working conditions.

•Provide fair and adequate compensation.

•Help create a sense of security and provide an environment to make suggestions and also complaints.

•Encourage ways to help employees fulfill their family responsibilities

•Provide equal opportunity for employment, development and advancement for those qualified.

•Encourage open communication in the organization.

•Provide competent, just and ethical management.

Responsibility to Community

• Be a good corporate citizen by following the laws of the land.

• Support good works and charities.

• Encourage civic improvements and better health and education.

• Take care of the property we are using.

• Take steps to protect he environment and natural resources.

Responsibility to Stockholder

• The business must make a sound profit.

• Experiment with new ideas and develop innovative systems and practices.

• Activities related to research and development.

• Investment in new equipment and facilities.

• Launch new products

• Reserves must be created for adverse times

• Stockholders should realize a fair return

BUSINESS ETHICS/ PRACTICES

Unethical practices recognised and prohibited by law in India

i) Trade Practice which –

- Prevents
- Distorts
- restricts

Competition in any manner

- Obstructs free play of competitive forces
- Impedes free flow of capital + Resources into stream of production
- Free flow of supplies into market
- Manipulation of prices

ii) Exclusive dealings

iii) Discriminatory dealings

iv) Re-sale price maintenance (RPM)

v) Territorial and other restrictions

vi) Boycott

vii) Predatory pricing

viii) Tie-in Sales/ Full – line forcing

Examples of Tie-in sales/ full –line forcing

• Tying – up Sales of Lifebuoy Soap with Sunlight Soap
• Car purchaser to pay for servicing of cars
• Purchaser of Gas connection to pay for Gas Stove
• Safe Deposit lockers only against Fixed Deposits
• Distributors required to maintain unreasonable minimum stocks of all other products.
• Newspaper charging joint-advertisement rate

ix) Misleading advertisement or false representations

Examples:
- False claim about standard, quality and grade of goods
- Falsely claiming second hand goods to be new goods
- Falsely claiming that goods have sponsorship or approval which they do not have.
- Giving false/ misleading facts about the goods of competitors

x) Failing to meet safety standards
xi) Hoarding and destruction of goods
xii) Conducting Promotional Contests

- Conducting/ holding contest including lottery, game of chance or skill for promoting directly or indirectly sale of any product.
- Underlying reason, product must sell by itself, by its own merits, its intrinsic value, no need of any prop.

xiii) Offering gifts or prizes which are not really free of cost

- Launching any scheme in which giving gifts or prizes is covered or recovered through price of the goods.
- If the manufacturer has taken price increase at the time of launching or before launching or immediately after launching, presumption is that the cost is recovered and hence it is prohibited.

xiv) Bargain sale, Bait and Switch selling

a) Manufacture/ trader put up an ad for selling goods at bargain price / concessional price, but such bargain price is not less than the normal price.
b) If very small quantity is offered at low price, than bait the customers to purchase goods at higher price or induce the customers to switch over to other goods of the traders.

ARTICLE:

THE PROPERTYLESS MANAGER: CULTURE & ETHICS IN INDIA

The history and culture of India offer good ground for the rooting of Business Ethics. The Gita concept of doing one’s duty without seeking for the fruits, Manu’s precept of inheriting debts as well as property, the Mauryan idea of accountability provide a basis for Gandhi’s belief that politics and business must work hand in hand for the development of the nation. Where has India gone wrong today? How have we reached a stage of such ethical cynicism? What do we do for the future? These are the questions that have to be tackled today.

Ethics in the Gita

There is an old French saying that has much relevance in today’s corporate world. It runs: “He who looks deepest into the past looks farthest into the future." Ti is important, in today's world, to look deep into the past in the hope of perceiving the needs of the future- more so because most of us can afford this luxury today. The subject of corporate ethics is very much relevant in today's world. Its relevance and urgency demand that it be taken up to a higher level of consciousness, and that business and industry make a serious effort to make it a part of their corporate culture.

About 1000 to 1600 BC, we have the first definition of social and business ethics in India. In the Bhagavad Gita, Krishna laid down the rights and obligations of each one of us. Krishna says that a manager that must look upon the task that he has been set, or that he sets himself, not in terms of personal gain or profit but purely in terms of its fulfillment and the satisfaction that this gives him. There can be no better definition of an ethical manager. When the author was a young Director of Hindustan Leaver in 1956, it became a public company, and had its first Board meeting with a very scholarly Chairman, Lord Heyworth, whose name had been associated with Unilever for 30 years. At the end of the board meeting he said that there was one little thing that he would like to discuss. Did we Directors of Hindustan Lever buy and sell Hindustan Lever shares or not? Did we get involved in any personal manner in the company, or was our involvement only professional, which was carrying out our duties to the company? After a brief discussion, the Chairman said if we felt we understood the market well, we could trade in other companies' share; but he advised us not to be associated with any personal gain in Hindustan Lever beyond our remuneration.

Many years later an American scholar, Elliot Jacques, created a new term for this kind of professional managers; he called him the propertyless mangers, one who manages the company but does not own any part of it as his personal property. Elliot Jacques was going strait back to Krishna's definition of true manager, one who does his job, not for personal gain but for sheer fulfillment of the task and the satisfaction which he derives.

Manu and Inheritance

Manu also made a change in our understanding of ethics. In the Aryan ethical code, there were rights and obligations for the sons who inherited their father's property. They also inherited his debt and the debt went down to two generations, so that if the first generation did not clear it, the second generation had to do so. This is similar to Roman law which, 1300 years later, laid down similar obligations. Manu created our caste system and gave a separate function to the trader or the merchant. After the Aryans and Krishna's concept of right and obligations, duties fulfillment and personal satisfaction, Buddha enunciated a beautiful truth. He said, the trader is like a honeybee, which sucks honey out of the flower but does not harm the flower. Buddha, of course, did not realize what we morderns know, namely, that the bee actually helps the flower by pollinating it; the bee helps the process of fertilisation. What Buddha did see was that while taking profit out, no harm must be done as one might do when in quest of personal gain.

Maurayan Accountability

For the first time the concept of accountability of mangers was laid down. In a complex, but carefully defined, operational framework, the Artha Shastra lays it down as a duty of a manager that he should be subject to an audit, that his accounts should be looked at every now and again for their clarity and truth.
In later centuries, India suffered various invasions, ethics weakened because the trader was often held to ransom and had recourse to extortion so as to be able to fend for himself and ethics no longer played the same role.

Akbar and the Operational Framework

However, ethics did come back in Akbar's time because Akbar gave us something indispensable for regular ethical functioning – a clear and stable commercial set up. We in the management know today that there can be no proper performance of duty, no ethical and social responsibility unless the framework in which one operates has been well defined, for quite often it is the vagueness that leads to loss of ethics. As the sage Kautilya earlier said, one must hold a public servant accountable: he not only has duty to perform but he must be sure it has been well performed to the satisfaction of all concerned.

The British Period

Akbar laid down an excellent land revenue system and clearly defined the duties of those who collected it. In fact, a British historian, Phillip Woodroffe writes in his famous book, Men Who Ruled India, that the British went back to Akbar and emulated him in three things: in giving India unity and a wholeness, a land revenue system and trying to bring about Hindu –Muslim unity. Woodreffe says the British succeeded in the first two but failed in the third. However, they did base their administration and policies on the foundation laid by Akbar.

This brings us to the British East India Company, where ethics wavered. However, one should say this to the historical credit of the British government operating till 1947 that they gave India a complex but a good system of rights, obligations, duties, an operational framework, such as we had in Akbar's time and Mauryan time.

Gandhi and the New India

Finally, we come to the new India. The British rulers had looked down upon trade and industry because traders came from a class of society where trading was considered to be an occupation suitable for the lower classes of society. But Gandhi belonged to the trading community himself, so he renewed the nexus between government and trade and industry of the Mauryan times and Manu's time. He openly joined with the business community; he felt there should be interaction between the administrators, the intellectuals and the businessmen, who should no longer be sidelined.

Today we should go back to this history from Gandhiji to Krishna. It is against this historical background that research on the subject should be done. We should look at the process of evaluation that began with the Vedas that specified the rights and obligations even of children who inherit property, and which finally moved to Gandhi. We may then discover what we need to do today to bring ethics back into business.

Students of industrial and business relation must regard their professional responsibility as something that goes beyond the statutory. The Statutory is something legal and its fulfillment should be taken for granted; real ethical obligation often goes beyond that. After World War II, times changed and the deterioration in ethics around the world has been causing great concern. Particularly, in the last 15-20 years, there have been examples like the Ivan Boesky affair in the U. S. A., the sunders affair in Britain, the Case of the German Company Director who, 7 years ago, was sent to jail for insider trading, the Recruit Scandal in Japan and the Whole range of activities now taking place in India, the present feverish stock market, the takeovers, the mergers (voluntary or forced), scams. This where insider trading is leading us to.

Professional Commitment of Manager

Allow me to go back to my own experience in Hindustan Lever. The author would take the liberty of relating a personal anecdote of the time when he was the Chairman of Hindustan Lever. He was once asked by a shareholder, “Mr. Chairman, how may shares do you hold in the company?” The author did not hold any, and said so. When asked what then was his stake in the company, he replied that it was purely professional. If the shares of the company went down in value today, tomorrow and the day after, the shareholders might loose some of their money, but the Chairman of the Company would be loosing peace of mind – he would be worrying what was happening to the company for which he was responsible, and whose shareholders were being asked to pay a price through a decline in its share value. Being the decision –maker is like being a surgeon, or a soldier who is loyal to the ethics of his profession, and not just concerned about personal gain. An ethical manager works for the organisation that employs him, and is remunerated not just by his own gain, but by the fact that the organisation grows and all the stakeholders are benefited. It was satisfying for the author that a number of shareholders got up and said that they were pleased to hear these were the standards of the company and its Managers.

Now, the whole ethical situation seems to have changed around the world. As for India, the less said the better. We all know the new sort of nexus between politics and business, between Delhi and Bombay that has set in. It should be revealing to know over the phone between Delhi and Bombay, which has made the wheels of business turn in unethical directions.

It is a matter of gratification that in the last 6 to 8 months, we are seeing a change coming. It would seem as if the same support to corrupt businessmen from the centre of administration no longer flows so easily as before; or atleast the corrupt now have the discretion to lie low.

The Ethics Course

Many years ago, the author was talking to someone who had been to Loyola University, Chicago. There he had come across a course in Business ethics and when asked how he had studied ethics, he gave the author an example of a case study that he had to analyze.

A young man who is just married is in an active traveling job. He leaves on Sunday evening, comes back on Thursday evening, goes to office on Friday and has only Saturday left to spend at home and also to catch up with the work for the week; on Sunday he is off again. The marriage begins to come under strain because his young wife finds he is away so much of the time. Becoming conscious of this, the case went on, the young man talked to the airlines he used and asked "do you think that once every two or three months you could give me a concession ticket or even a free ticket." "Certainly" they replied, "you travel so much we would be glad to give a free ticket to your wife." Then, of course, a hotel in one of the nicer places where he could spend a weekend made a similar offer. The executive's wife went with him for a long weekend once every six or eight weeks. There was amity in the family. The company lost nothing. In fact, it was indirectly a gainer because executive's marriage was happier.

To analyze this case clearly poses an intricate problem from the ethical point of view. These are the sort of issues that an ethical sensitive person has to deal with in business.
It is therefore, fitting that we should go deeply into the subject, discuss cases, and problems and bring the issues to the level of general awareness, at least in

the academic and business community. Our culture, our past history are rich in this area; but today we have become poor. Where do we go in the future?

ARTICLE:

CORPORATE EHTICAL AND SOCIAL RESPONSIBILITY IN ACTION

Are Efficiency and self interest everything?

Advocating ethics in business is like advocating motherhood; nobody is against it! Yet we find that the theory of business organizations, taught in class rooms all over India, and indeed in most countries of the world, simply ignores issues of human decency, justice, civic, responsibility and accountability. The commonly proposed model for business behaviour contains two elements, which exclude ethics or social decency. These elements are; first efficiency interpreted as profit maximizations and second, “rations behavior which in practice means that a corporations should act solely in its own interest Other considerations like the welfare of the employees, fair play to customers, suppliers, and indeed to the local and national community, are to be taken into account into only as a means to maximize the corporation’s wealth. One has only to read even recent authors like Irving Kristol. Michael Nova, George Gilder,’ not to mention the high priest for such thinking, Milton Friedman, to come across statements like these. Indeed the celebrated India economist Amartya Sen, in his 1987 book on Economics and Ethics raises the question. “If rational economic behaviour requires exclusive attention to self-interest, can we conclude that universal selfishness is required for total human rationality? How rational is a soldier who dies for his country? Is there no distinction between a hero and coward?

All this thinking regarding the primacy of self interest in business makes a distinction between the businessman as an individual citizen who has to act morally and be socially responsible and as corporate executive. In the latter capacity when he enters the precincts of his business he has to leave a ethical considerations at the doorsteps and act solely in the interest, material and financial of the corporations and its shareholders. The rest is not his business it is the business of the state.

To understand the specious nature of this distinction, it is enough to imagine the managing director of an automobile company being asked at the dinner table by his son, “ Dad is it true that your company make s cars that kills people? “ Can we imagine the father responding, “ Well, son, this is hoe business is done?” What sort of respect could that man expect from his own family. The son intuitively knows that what his fathers is doing is wrong and condemnable, whether he is a private citizen or a corporate executive out to maximize his company’s profits.’ Ethics is not anticapitalist nor antibusiness. It asks the same questions of business that if asks individuals, hospitals, schools and indeed the government and the law- namely, “ Is it right or wrong?”

In India we do not have writers or businessman who openly express such crass sentiments. The moralistic climate of the country makes this impossible, but in practice of our practice, thousands of our businessman act in exactly this fashion.

Adam Smith’s View

Adam Smith’s in 18th Century capitalist manifesto is often cited as a justification for these views. What people forget is thaw the same smith is also the author of an equally well-known treatise. The Theory of Moral Sentimenrts. While proclaiming that free enterprise or capitalism as we tend to cal it, is the best economic system as far as productivity is concerned, Smith also held that it is not immune to greed and selfishness. It is interesting to note that roughly the same thing is said by Pope John Paul. If, in his recent widely applauded social encyclical letter entitled Centesimus Annus **(*100 years)**. This letter, as its name implies, was published in 1991 to commemorate he centenary of the fist papal document on social questions entitle Rerum Novarum (All things new). In his letter, Pope states that there can be no longer be any doubt today that a free market economy is its best ability to foster compassion, to care for the poor and to protect the environment.

Adam smith went so far as to assert that the selfishness and greed that capitalism itself encourages could ultimately destroy the system itself. How can it be otherwise? I f people are constantly cheating each other and other lawyers have constantly to file suits to make contracts work, and one cannot get a telephone or a necessary permit without bribing, the economic life of the country will come to a grinding halt, precisely because everybody, every corporation is thinking only o fit own short-term financial interest," Is these not what we in India are experiencing today?

The self-interest thinking outlined above was popular in the eighties all over the world, particularly the US where is a successful Wall Street businessman, Ivan Boskey could proclaim at the convection of the University of California, in 1985; "Be proud to be greedy and selfish ness when enter the world business, because these are the virtues that you motivate you higher and higher.

We shall now consider some practical areas of ethics in actions.

Ethics and competition:-

It has been cynically said that ethics, corporate social responsibility, high sounding credos and codes and idealistic mission statements are in direct proportion to the prosperity of a company and in inverse proportion to the severity of the competitions it faces. In other words high values area luxury that only wealthy, successful companies can afford. Values are all right for Tata Steel, TELCO, AT & T, Johnson and Johnson, IBM. Such companies can afford to give excellent treatment to their employees, high value for money to customers, show concern for the environment and the rights of public and all the rest, which figures under Business Ethics. But what about the struggling little outfit? Thus it is pointed out that IBM and AT & T have departed from their previous policy of no retrenchment when they faced competition and no longer had the field to themselves.

The first answer to this query is that the companies known for their ethics adopted their high values not when they had become big and prosperous , but when they were small outfits, and it is preciously their values that gave them the backing of the pubic which enabled tem to grow to their present giant size.

Thomas Watson insisted on the value of job security for employees during the great depression when IBM's annual revenue was 20 million $; today it is 40 billion $. Delta Airlines one of the most trusted airlines of the US formulated its Ethics Code is distant days when it possessed only 12 planes having a total value of 2.5 million $. Today the company equipments is valued at 2.5 billion $. General Robert Wood Johnson formulated Johnson and Johnson credo nearly 45 years ago when the company was a midget its founder J N Tata in 194 when the company was just starting and was going to produce only 50 tones of steel. It has persisted with these values over the last nearly 90 years and become India's largest most respected and most profitable company precisely because it is perceived by the public as a value-based corporation.

We may therefore concluded by asserting that striving for high values is not a luxury for the rich; rather it is the way to become rich if only one has the vision and the courage to embark upon this way.

As for the statement that AT & T and IBM have departed from their previous policy of no retrenchment; one would have to say that there is no strictly ethical principle involved in retrenchment when a company finds it impossible to continue otherwise. What is important is the way in which such retrenchment is handled; the compassion, the fair play; the serious attempt to soften the blow for the workers by every means possible.

The Indian Experience:-

Of course, the monopolist who believes only in profit maximization does not accept this. Let us recall the situation, which prevailed in India till July 91. For 40 years we were afflicted with governments proclaimed that the economy had to be strictly controlled in the interest of the people, that the competition was a wasteful luxury which is a poor country could not afford. All that the government seceded in doing, as everybody knows, was to paralyzed the growth of India's economy and foster an environment conducive to the creation of monopolies and the consequent exploitation of the public which was obliged to purchase sub-standard gods at exorbitant prices. Meanwhile huge profits were raked in by the lucky few who, by hook or by crook, had managed to secure an industrial license. Their biggest task, thereafter was often to make sure that nobody else got a license. To ensure this, they would not hesitate to use every means, including bribery and getting another license under a bogus name themselves so as to plead sufficient capacity. The second license would of course never be used. It had served its real purpose to inhibit competition. Is it surprising, then, that Indian industry has lost its competitiveness and creativity, and will know have a hard time to shape up and face world competition to export its products in the new dispensation that has been ushered in.

Growing Perception of Need for Ethics:-

Seeing the Indian experience, one can understand how so many businessman today proclaim that ethics and social responsibility are necessary, for the very survival of their companies precisely because of the highly competitive climate that prevails today. Thus, it is commonly held that one important reason, for the loss of competitiveness of American business in the seventies and eighties was precisely its virtually monopolistic global dominance and the absence of serious competition. David Halberstram forcibly makes this point with respect to the US automobile industry in his classic book The Reckoning" The industry could sell anything it made, he maintains, it grew fat and profit soaked, greedy for ever greater profits, it would spend nothing on improving quality, but continued to palm offs gas-guzzling mastodons with built in obsolescence to a helpless public almost the identical situation that prevailed in India. Then the day of reckoning dawned in 1973 when petrol suddenly quadrupled in price and the public started demanding high quality fuel efficient, compact cars. The American auto – industry found itself unable to face the imports, particularly from Japan, and had finally to beg for protection from the government.

No wonder then, that the Ivan Boesky type of thinking has been al but abandoned today. Instead, ethics seems to have suddenly become the "in thing" and a majority of companies have drawn up codes of Ethics today, and their chief executives proclaims that ethics and social responsibility are necessary for the very survival of their firms, precisely because of the highly competitive climate that prevails today. Thus Ran Araskog, Chairman of ITT Rayonnier states, "No business enterprise remains viable over the long term if the actions of its managers are based solely on financial grounds and they fail to take the human element into account.” A sound business strategy is not enough,” says Robert Haas of the Levi Strauss Co., “A company’s value what it stand it stands for what its people believe in are crucial to its competitive success. “ Robert Cushman, Chief Executive of the Norton company of Worcester Mass, has this to say, “ The climate in which business operates his become cold and unfriendly today as a result of revelations of unethical behaviour that have rocked the nations and the world. People have lost their trust in business and governments are prone to investigate them. If no other reason than this, it would be wise for a firm and it individual managers to be concerned worth ethics. Besides ethical behaviors is the basis of Norton’s success.

Ethics and Profits:-

Five years ago says “Karen Gaertner Professor of Management at Georgetown University, “you had to go to some length to convince students that goods ethics and god business could go and in hand; we had drag out the Tylenol case as the one and only example. Now a lot of things are in our favour. The bad guys have been prosecuted. It turns out that bad ethics as bad business and that’s clear as a bell out there. What’s more there’s now plenty of external evidence that says good ethics is a god business.” Or a repot appearing in Business Roundtable put it, after surveying 10 companies, “one of the myths about business is that there is a contradiction between ethics and profits”. This view is also expressed by the Thomas Green, vice-chairman of the Norton Company at the time it is drawing up its code of ethics. “We see no conflicts” he says “between attention to profits and attention to ethics”.

Finally, it is pertinent to quote the much respected doyen of Indian industry, JRD Tata. Inaugurating the JRD Tata Foundation for Business Ethics in XLRJ Jamshedpur on 4 march 1991, Mr. Tata had this to say., “The most important cause of the suspicion and hostility to private enterprise in our country ahs been the fact that the ethical standards adopted by some elements in business and industry have in some cases been atrociously low. Immense damage has been caused to the image of private business and industry in the last 50 years thorough the depredations, misdeeds and conspicuous expenditure of a few individuals heading large enterprise who, in their pursuit of wealth, profit and self-aggrandizements, have wantonly disregarded the public interest." Mr. Tata concludes with the words; "Ethical values have too often been ignored in recent years in the belief that quicker profits would be the result. Our own experience in Tatas has shown that this is a false belief".

We could sum u the question of ethics and profits by saying that at least in the long term, value driven companies which know what they stand for and make ethical, socially responsible decision will do better, though in the short run, they may sometimes lose money.

Ethics and Law:-

The relationship between ethics and the law can be quite tricky to define. Not everything that is illegal is immoral, just as not everything that is immoral is illegal. This is why most companies lay down a simple ethical requirement to be observed by all employees all laws connected with the business are to be observed. However as Ron Arakog says," I want mangers also to realize that some actions can be legal, but still questionable." In such cases, an ethical companies would expect its officers t subject the matter in question to serious ethical analysis from al points of view. Similarly, certain laws may possibly be considered to be inapplicable in certain situations. A good example is the explicit law that prevails in America against bribing foreign officials in order to secure an order. The law seems perfectly reasonable until one realizes that in some countries minor officials except, and are even tacitly permitted by local convention to accept, small gratuities for the performance of their normal duties. Thus a truck weighing station official in some counters is normally given a nominal consideration to certify a vehicle, which fully complies with the law. If he is not given this amount because the law of the land does not mention any such payment, a company would see its drivers harassed and its shipments delayed. Numerous similar examples can be given from many different countries of the world. Some companies therefore, do not consider this to be corruption and permit their people to give the small amount excepted, provided it is accounted for. The reasoning is that no special favour is being sought the company is just claiming its legal right which, however, cannot be contained without giving a small customary payment.

The case is quite different when top officials, like ministers of government, demand massive payoffs before they finalize an order; they permit the company, at least implicitly, to inflate the estimate by a corresponding amount, so that the kickback is actually paid by the country's own exchequer. We have all heard of such scandal in various countries of the world including India. They certainly bring discredit to the company, though in the short run it does gain.

An organisation that is keen on ethical functioning should include the observance of all ethically sound laws connected with the business as part of its code of Ethics. It should insist that no real bribes are to be pad, i.e., amounts, large or small, given to obtain special favour to which the company is not legally entitled. This would mean that other companies are being deprived of fair consideration or the nation itself being defrauded.

Where a company his won an order by virtue of its own quality and cost, and kickbacks to be included in the final cost) are demanded, the situation becomes more tricky. However examples are not lacking or companies that value their ethical principles so highly that they prefer to lose the order rather than comply they view compliance as the thin edge of the wedge, which would bring a flood of other unethical practices in its wake. The situation is similar went a company has fairly won a contract and then discovers that it is required to abide by an unethical law of the land; e.g. to practice racial discrimination in its hiring of personnel. Such a dilemma faced the Cummins Engine Corp some years ago in South Africa. After analysis of the situation from the ethical, economical and legal angles, the company finally arrived at the hard decision that it would reject the order. Making this decision was a bitter experience for Cummins because it found that the orders the USA were eagerly snapped by its less ethical competitors outside the USA. However, Cummins continued to believe it had made the right decisions.

Why is Ethics Important?

a) **Ethics corresponds to basic human needs:** The first obvious reason for being ethical is of course that the top bosses might otherwise land in jail and the company be hit with a heavy fine. However this is not really an ethical consideration. It is rather a matter of expediency.

On a deeper level, we believe that most people want, and even need, to be ethical not only in their private lives, but also in their business affairs where a manager knows his decisions may effect the lives of thousands perhaps even hundreds of thousands of people. What's more, most people want to be apart of an organisation which they can respect and be publicly proud of because they perceive its purpose and activity to be beneficial to society. Most top management would like to respond to this need of their employees; and they themselves feel an equal need top be genuinely proud of the company they are directing. These basic ethical needs are probably one of the most cogent reasons for ethical concern on the part of the organizations.

b) **Values create credibility with the public**: This point hardly needs to be laboured. A company perceived by the public to the ethically and socially concerned will be honoured and respected even by those who have no intimate knowledge of its actual working. There will be an instinctive prejudice in favour of its products, since people believer the company gives value for the money. Its public issues, whether in the form of equity, convertible bonds or fixed deposits will attract an immediate response. We know how easily a company like Larsen and Turbo or nay Tata Company can get money from the public. Tata-Timkens recently receive 100 times more applications for equity than they needed.

Sir Arvi Parbo, chairman of Australia's giant Broken Hill Proprietary Co (BHP) has this to say, "Gaining the confidence of the community is vital to the business sector. Public opinion is the most powerful force in a democratic society. We cannot afford to ignore it."
The most obvious outcome of public cynicism and lack of confidence in a particular company or, worse still, in a whole industry of course increased government regulation. These regulatory laws have as their objective to teach industry the lesson that the pursuit of self interest must be qualified by the need to have regard for the impact of its actions on others.

Regulation is necessary but a plethora of laws controlling business is am unsatisfactory way of achieving higher standards of behaviour. Such laws are expensive and difficult to administer they open the way for corruption and they lead to the notion that ethical behaviour requires nothing more than compliance with the letter of law.

c) **Values give management credibility with employees:**

Values provide a common language for aligning a company's leadership and its people, "says Robert Haas of Levi Strauss. " What Haas means is that organizational ethics values and language. The management his credibility with its employees precisely because it ahs credit with the public. Neither sound business strategy, nor a generous compensation policy and fringe benefits can fully win employee credibility; only perceived moral and social uprightness can.

The credibility gained by the top management of an ethical company and the trust generated among the employees finally produce the feeling that the company does not belong exclusively to the share holders but rather to all the employees. This phenomenon can be seen at work in those Indian companies which have a reputation for ethical and socially responsible behaviour. One has but to talk to any level of employees in a firm like TISCO, and before long one will catch the toe of affection with which they refer to the company as hamari company, our company. The value of such a family feeling in an organisation cannot be exaggerated. It holds even when the company is forced to retrench some of its people. In this most difficult situation for any firm, it helps enormously if employees are convinced of the firm's honesty and decency and of the fact that it will make every effort to ease the transition of workers from the firm either to retirement or to some other job. The family spirit prevailing in an ethical company also virtually insures it against labour strife.

TISCO has not experience a strife against the management for 58 years in a country and an industry plagued with unrest.

d) Values help better decision making:

Another point of great importance is that an ethical attitude helps management make better decisions, i.e., decisions which are in the interest of the public, their employees and the company's own long term god, even though decision making may have to be slower. This is because respect for ethics will force a management to take al aspects of a question into consideration, both, the economic aspects, and the social and ethical aspects. There is no question here of replacing economic considerations with ethical ones. Decisions made for purely ethical reasons without regard to economic realities, are at best altruistic and altruism is without regard to economic realities into account; otherwise it would not business must take economic realities into account otherwise it would not survive long. Hard decisions which have been studied from, both an ethical and an economic angle are more difficult to make but they will stand up against all odds. Layoffs of workers, closing of plants toxic waste management safety in production processes and in the final product are just do issues which definitely require both economic and ethical analysis and even trade-offs though in trade offs, basic ethical principles will not be compromised.

Institutionalizing Corporate Ethics:-

A firm that seriously desires to operate in an ethical and socially conscious manner would do well to Institutionalizing its Ethics. Such Institutionalizing would requires 3 steps:

- Drawing up a company policy or code of ethics.
- Familiarizing its employees at all levels with the code and with the processes of ethical reflection on complex issues through special training. Programmes, or through special sessions on ethics in the course of regular tanning programmes.
- Ensuring the implementations of the Code by means of a formally designated Ethics Committee of the Board of Directors.

The Ethical Code:

A code of ethics that is going to be observed cannot be drawn up by an individual or a small group of the top management and then promulgated without discussion among the employees Ethics is too complex a question to be death with this way. Such a code will lack credibility among the employees and may even provoke decisions. To be acceptable, an Ethical code had to be internalized by the employees. Hence drawing one up is a company like Norton introduced its ethical code in the 70's. On the other hand, a company might have a ling history of ethical conduct and a testament coming from its founders which successive generations have endeavored to live up to. TISCO would be a good example of a company like this, this code would only have to be formally promulgated or publicly declared.

A large number of businessmen have drawn up ethical codes today, owing to the widespread perception that this is necessary top gain the good will f the public. However, having an ethical code and doing nothing to ensure its implementation only leads to cynicism on all sides. This is, in fact, a form of unethical and deceptive behaviour. Therefore, besides having such a code, steps must be taken to see that it is implemented. The first step is to ensure that the employees at all levels are familiar with the code and understand that it is not meant to be mere window dressing but is to be implemented and that the company is serious about the matter.

Making the Code Known:

First, the company's ethical codes should be printed and copies sent to every employee. One of the documents that every now employee should receive together with his appointment Order and the rules of service, must be a copy of the company's Code of ethics.

Secondly, the company should help employees understand the implications of the code for their daily work life. This can be done by special sessions on ethical and social responsibility during regular treading programmes. This is particularly important when new employees are being given pre-induction training.

These special sessions also enables employees to realize the complexities of ethical thinking and decision making and the number of factors that have to be taken into account if the final decisions are to be correct and for to all concerned including the company itself. For, we must repeat that ethics does snot mean that a company ahs to sacrifice its own interests or those of its employees.

Implementing the Code:

The first step in the implantation of any ethical codes is that the management should let it be known that unethical or anti-social conduct on the part of the employees will not be tolerated, no matter what be pretext might be, even if it is to make greater profits for the company. We are not referring here to dishonest behaviour through which a company is defrauded by its employees

Action taken against such erring employees is totally in the company's own immediate interest and cannot b treated as proof of the firms ethical. There are border lie cases, where the company does not suffer any loss, but the employee gain through a particular type of behaviour. An example, of this is calming first class train fare to which an employee is entitled but traveling by a lower class and pocketing the difference. Many companies view this as a malpractice while others do not. Violation of the rule in the first case would constitute personal unethical behaviour by the employee against which action may be taken. It does not impinge on corporate ethics.

Serious implantation of a ethical codes requires that employees found deliberately violating the code would be immediately taken to task, in a manner befitting the gravity of offence. A few well-publicised cases like this would have a salutary effect on the entire personnel of the company and demonstrate that the firm is serious about its ethical.

The second step in the implantation of the ethical code is the constitution of an Ethical Committee. What would be the functions of the committee?

1) It would solve problems that arise in the gray area of ethical polciy and recommended decisions to the board of directors. This is surely an extremely important function, since a number of such problems would certainly arise. We have quoted a case where Cummins Engine decided it could not take up an important contract. The decision was made by the Board on the recommendations of the Ethics Committee.
2) The Committee would have to make the policy decisions of the Board known so that ht employees would understand the reasons behind the. This is particularly important in the case of decisions

which might affect the immediate financial interest of the company.

3) The Committee would monitor compliance with the ethical policy of the company and make periodic reports to the Board. This implies that all employees would be encouraged to report clear violations of the company's ethical code. This should not, however mean that an internal spy system is sought to be set up which would undermine the mutual trust that is essential for the proper working of the company.

4) Finally, one of the responsibilities of the ethical Committee would be to recommend to the Board any changes in the company's ethical policy which the committee feels should be made. This is an important point. It is recognition of the fact that ethics being linked with the concrete circumstances of the daily life would need periodical review. It is a fact that as time passes certain ways of behaviour are no longer seen as unethical owing to radically different situations, and changed modes of thinking. For example could be taken from the world of fashion. On the other hand, certain modes of behaviour which were previously considered acceptable are seen as unethical.

If an ethical code is to remain relevant and a living document for the guidance of a company's employees, it must take changing needs into account.

Two Kinds of Ethical Committee:

The Ethics Committee referred to could be a committee of competent insiders and outsiders appointed by the Board of Directors, which would report to the board. None of its members would necessarily be a member of the board. Such a committee would be able to perform the first and the fourth functions or the committee mentioned above. It would have difficulty assuming a monitoring rule or issuing bulletins explaining decisions of the Board. Its authority would be insufficient for these purposes. This type of committee would have credibility in the company and among its own members only if consisting mainly of officers who have a background of Ethics studies, e.g.: graduates of Yale Divinity School.

The second type of committee is a Committee of the Board and would include a majority of board members, though some outsiders may also be invited. It could have one of the officers of the board as its convener. Such a committee obviously has greater authority. The Ethics committee of the Norton Company is of the kind named the Chairman and CEO is its Convener.

Ethical and Social Audit:

An important step is taken bys companies that are serious about their Ethical and social responsibility is the institution of a periodical Social Audit conducted by outsiders of unimpeachable honesty and competence.

The Tata Iron and Steel Company instituted such an audit in 19823 and published the results in the form of a booklet made available to the employees and to any other person who wanted it. What's more the management ahs since then paid serious attention to the lacunae pointed by the audit report and the progress registered iris visible.

Conclusion

Corporate Ethical and Social Responsibility is an intensely practical issue which should engage the serious attention of the management of any company today. While such responsibility can impose onerous burden on the management of any corporations, it also brings its own rewards.

CORPORATE GOVERNANCE

Corporate Governance – Historical Perspective

- The seeds of modern corporate governance were probably sown by the Watergate scandal in United States. As a result of the subsequent investigations, US Regulatory and Legislative Bodies were able to highlight control failure that had allowed several major corporations to make illegal political contributions and to bribe government officials. This led to the development of the Foreign and Corrupt Practices Act of 1977 in USA, that contained specific provisions regarding the establishment, maintenance and review systems of internal control.

- This was followed in 1979 by the Securities and Exchange Commission proposals for mandatory reporting on internal financial controls. In 1985, following a series of high profile business failures in USA, the most notable one of which being the Saving and Loan collapse, the Treadway Commission was formed. Its primary role was to identify the main cause of misrepresentation in financial reports and to recommend ways of reducing incidence thereof.

- The Treadway report published in 1987, highlighted the need for a proper control environment, independent audit committees and an objective Internal Audit function. It called for published reports on the effectiveness of internal control. It also requested the sponsoring organisations to develop and integrated set of internal control criteria to enable companies to improve their controls.

- Accordingly COS (Committee of Sponsoring Organisations was born. The report produced in 1992 introduced a control of frame work which has been endorsed and refined in the four subsequent UK reports: Cadbury, Rutteman, Hampel and Turnbull. While development in the United States stimulated debate in the UK, a spate of scandals and collapses in that country in the late 1980's and early 1990's led shareholders and banks to worry about their investments. These also led the Government in UK to recognize that the then existing regulation and self-regulation were not working.

• Companies such as Polly Peck, British & Commonwealth, BCCI and Robert Maxwell's Mirror Group News International in UK were all victims of the boom-to-dust decade of the 1980's. Several companies, which saw explosive growth in earnings, ended the decade in a memorably disastrous manner. Such spectacular corporate failures arose primarily out of poor managed business practices.

•It was in an attempt to prevent the recurrence of such business failures that the Cadbury Committee, under the chairmanship of Sir Adrian Cadbury, was set up by the London Stock Exchange in May 1991. The committee, consisting of representatives drawn from the top levels of British Industry, was given the task of drafting a code of practice to assist the corporations in UK in defining and applying internal controls to limit their exposure to financial loss, from whatever cause.

Cadbury Committee

•The stated objective of the Cadbury Committee was "to help raise the standard of Corporate Governance and the level of confidence in financial reporting and auditing and setting out clearly what it sees as the respective responsibilities of those involved and what it believes is expected of them".

•The Committee investigated accountability of the Board of Directors to shareholders and to the Society. It submitted its report and associated "Code of Best Practices" in December 1992, wherein it argued that methods of governance needed to achieve a balance between the essential powers of the Board of Directors and their proper accountability.

•The resulting report, and associated "Code of Best Practices", published in December 1992, was generally well received. Whilst the recommendations themselves were not mandatory, the companies listed on the London Stock Exchange were required to clearly state in their accounts whether or not the code had been followed. The companies that did not comply were required to explain the reason for that.

Cadbury Committee and after

•IT would be interesting to note how the corporate would react to the Cadbury Report. The report in fact shocked may by its boldness, particularly by the code of Practices recommended by it. The most controversial and revolutionary requirement and the one that had the potential of significantly impacting the internal auditing was the requirement that the director should report on the effectiveness of the company's system of internal control. It was the extension of control beyond the financial matters that caused the controversy.

•Paul Ruthman Committee constituted later to deal with this controversy watered down the proposal on the grounds of practicality. It restricted the reporting requirement to internal financial controls only as against the effectiveness of the company's system of internal control as stipulated in the Code of Practices contained in the Cadbury Report.

•It took another 5 years to get the original Cadbury recommendations on internal control reporting re-instated. Public confidence in UK continued to be shaken by further scandals and Ron Hampel was given the task of chairing the committee on Corporate Governance with a brief to keep up the momentum by assessing the impact of Cadbury and developing further guidance.

•The final report submitted by the Committee chaired by Rom Hampel had some important progressive elements, notably the extension of Directors' responsibility to all relevant control objectives including business risk assessment and minimizing the risk of fraud.

•The combined Code was subsequently derived from Ron Hampel Committee's Final Report and from the Cadbury Report and the Greenbury Report. (Greenbury Report. Which was submitted in 1995, addressed the issue of Directors' remuneration.) The Combined Code is appended to the listing rules of the London Stock Exchange. As such, compliance is mandatory for all listed companies in the UK.

•The stipulation contained in the Combined Code require, among other things, that the Boards should maintain a sound system of internal control to safeguard shareholders' investment and the company's asset and that the Directors should, at least annually, conduct a review of the Group's system of internal control and should report to shareholders that they have done so and that the review should cover all controls, including financial, operational and compliance controls and risk management.

•Subsequent developments with regard to Corporate Governance in UK led to the publication of Turnbull Guidance in September 1999, which required the Board of Directors to confirm that there was an on-going process for identifying, evaluating and managing the key business risks. Shareholders, after all, are entitled to ask if all the significant risks had been reviewed (and presumably appropriate actions taken to mitigate them) and why was a wealth-destroying event not anticipated and acted upon.

•In this context, it was observed that the one common denominator behind the past failures in the corporate world was lack of effective Risk Management. As a result, Risk Management subsequently grew in importance and is now seen as highly crucial to the achievement of business objectives by the corporates.

•It was clear, therefore, that the Board of Directors were not only responsible but also needed guidance not just for reviewing the effectiveness of internal controls but also for providing assurance that all the significant risks had been reviewed. Furthermore, assurance was also required that the risks had been managed and an embedded risk management process was in place. In many companies this challenge was being passed on to the internal audit function.

The Combined Code on Corporate Governance – July 2003:

•This is the Code of Corporate Governance applicable to all listed companies in UK, particularly London Stock Exchange- as part of the Listing Agreement

•This has been modified and revised by the Financial Service Authority UK in July 2003 and replaced Combined Code issued by Hampel Committee on Corporate Governance in June 1998. The new code came into force from November 1, 2003

•Listed company is required to make disclosure statement in two parts:

•i) How much it has complies provisions of the Code

•ii) Declaration that either it complied all or whether it failed to comply and explanation. “Comply or Explain” approach.

•Departure from the code is tolerated, provided sufficient explanation and justification given to shareholders.

•Code does not override general requirements of Company Law.

•Code also gives elaborate guidance notes on how to comply wit various parts of the Code like “Internal Control”, “Audit Committee”, “Remuneration Committee”, “Nomination Committee”, Role of Executive Directors and Non-Executive Directors and Chairman, etc.

What is “Corporate Governance”?

▪It is a set of Methods / Practices by which business is carried on, directed and controlled in a corporate form of business organization.

▪Board of Directors primarily responsible for governance.

▪Quality of Corporate Governance determine the growth and future of the business.

What is “*Good* Corporate Governance”?

The concept of corporate governance is defined in several ways because it potentially covers a large number of distinct economic phenomena.

▪Earliest definition of Corporate Governance by the Economist and Noble laureate Milton Friedman is to conduct the business in accordance with owner or shareholders desires, which generally will be to make as much money as possible, while conforming to the basic rules of the society embodied in law and local customs.

▪Over a period of time the definition of Corporate Governance has been widened. It now encompasses the interests of not only the shareholders but also many stakeholders.

Some Other Definitions:

▪According to some experts "Corporate Governance means doing everything better, to improve relations between companies and their shareholders; to improve the quality of outside Directors; to encourage people to think long term; to ensure that information needs of all stakeholders are met and to ensure that executive management is monitored properly in the interest of shareholders".

▪J. Wolfensohn, President, World Bank "Corporate Governance is about promoting corporate fairness, transparency and accountability".

HEIGHTENED GLOBAL AWARENESS OF CORPORATE GOVERNANCE AFTER THE FALL OF ENRON CORPORATION IN 2001

ENRON CORPORATION SCANDAL

▪Enron Corporation collapsed in December 2001.

▪Only one-third of Americans feel that large companies have ethical business practice and 26% believe they are straight forward and honest to the consumers and employees.

▪**Jeffrey R. Immelt, CEO of General Electric**

"Credibility and trust is everything in business, because of Enron that trust has evaporated".

▪Enron by their money power influenced the elected officials of the Government - the impression is that Enron paid the cop on its beat to take a nap.

▪80% of the Americans believe corporate executives put their own personal interest ahead of shareholders interest.

▪Parking liabilities off Balance-sheet, fudging accounts, stock promoting, bloated executives pay packages, massive stock option grant are some of the malpractices indulged in by Enron.

Corporate Governance in India

▪India ranked as one of the top most countries in Corporate Governance as per the recent study.

▪Study by Grant Thornton – the International Business Owner Survey conducted in 16 countries in January 2003.

▪More than 71% of the closely held companies tightened up internal control compared to 66% globally.

▪25% Indian businesses have got Independent Directors in place and 46% have formed Audit Committees.

▪Many Indian Independent businesses have pre-empted the imposition of legal Corporate Governance by taking steps to reduce the risk of corporate or financial malpractice.

▪Indian businesses along with Mexico, Singapore and U.S. are in the forefront in forming Audit Committees.

What are established Codes of Good Corporate Governance?

▪**Notable reports in India:**

i) Desirable Code of Corporate governance by CII
ii) Report of Kumarmangalam Birla Committee on Corporate Governance
iii) Report of Naresh Chandra Committee
iv) Report of Narayan Murthy Committee

Important International Reports

- Report of Cadbury Committee
- Report of Greenbury Committee
- The Combination Code
- The OECD Code on Corporate Governance
- The Blue Ribbon Committee on Corporate Governance in USA
- Rules under Sarbanes-Oxley Act of 2002 of USA

CORPORATE GOVERNANCE – The Role of Board of Directors and the Management:

▪Three constituents of Corporate Governance are Shareholders, Board of Directors and Management.

▪Management has greatest responsibility for introducing good Corporate Governance.

▪Primary responsibility for good governance rest with Board of Directors

ROLE OF MANAGEMENT

MISSION

▪ Foundation for Corporate Governance is the Corporate Mission.

▪ Primary task of management is to create Compelling Mission.

▪ It is the power of the mission that creates leaders who lead corporations to success.

• **The objectives of your Corporate Governance should be:**

➢ to create leaders who would lead Company to achieve your mission and

➢ to create next generations of outstanding men and women to lead Company in the new millennium.

THOUGHTS TO PONDER:

▪ **It is no use saying "We are doing our Best". You have got to succeed in doing what is necessary.**

WINSTON CHURCHILL

▪ **What is important is to keep Learning, to enjoy Challenge, and to tolerate Ambiguity. In the end there are no certain Answers.**

MARINA HORNER

▪ **We are what we Repeatedly Do. Excellence, then is not an act but a Habit**

CORPORATE GOVERNANCE

– Role of Board of Directors and Shareholders –

- Primary responsibility for good governance rest with Board of Directors
- Kumarmangalam Birla Report and Companies Act lay down mandatory provisions of corporate governance. Rules of Corporate Governance which existed before Companies (Amendment) Act, 2000
- Division of power between Shareholders and Board of Directors, but the Board accountable to Shareholders.
- The Board comprises of Executive and Non-Executive Directors and Independent Directors
- Directors per se, no power, collectively all powers under Section 291
- Company should invest the funds of the shareholders only in the business for which it is registered.

Restrictions on Remuneration of Directors

- Total 11% of net profit
- All whole-time Directors – 10%
- Per whole-time Directors – 5%
- Other Directors – 3% or 1%
- Satisfy conditions of Schedule XIII, if net profit is inadequate.

Appointment of Directors

- Not less than 2/3 by Shareholders
- Every year retire 1/3 Directors
- Directors appointed by the Board should retire at shareholders meeting

▪Not more than 1/3 can be non-retiring Directors

▪Appointment of MD and other Directors should comply with conditions of Schedule XIII.

▪In many cases Management makes sure that outside Directors are docile or do not interfere through diplomatic selection and by not giving them sufficient information

▪Under Section 255 Shareholders quota of Directors not less than two third. Usurped by Management. Election of Director by Shareholders frustrated through mechanism of Board appointed additional Directors

▪Many Companies hold AGM in remote place by shifting Registered Office, so that they do not have to face agitated Shareholders.

▪In many Companies Board of Directors is a nominal Board – they call it a Legal Board – Real Board is the Board of Management comprising Senior Executives headed by Managing Director.

▪Only matters requiring legal approval comes to Legal Board for rubber stamp. Business transacted never matches with the agenda. Most of important items slipped under omnibus item “other business with the permission of the Chair.”

▪Minutes list number of documents as placed before the meeting, mostly none was placed.

▪Agenda sent without explanatory note or relevant documents, they are given only at the meeting.

▪Many times half of the Board minutes contains matters never discussed. They were added after the Board meeting as the minutes was kept open until the next meeting. The Directors were only informed of these additions.

▪Sometimes meeting held with only 24 hours notice or without written notice. (No provision under the law for length of the notice)

▪Foreign Directors many times never attend the Board Meetings. There are instances they have never seen India. This is possible by granting leave of absence at every meeting whether it was asked for or not.

CORPORATE GOVERNANCE

- **Enhancement of long term shareholder value**

- **To protect interests of other stake holders like:**

  a) **Customers**
  b) **Suppliers**
  c) **Creditors**
  d) **Deposits**
  e) **Employees**
  f) **Government, and**
  g) **Society**

According to this definition the Corporate Governance is:

i) the system by which business corporations are directed and controlled,
ii) its structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the Board, managers, shareholders and other stakeholder,
iii) Spells out the rules and procedures for making decisions on corporate affairs,
iv) it provides the structures through which the company objectives are set,
v) also provides the means of attaining those objectives, and
vi) means of monitoring performance.

Constituents of Constituents of
CORPORATE GOVERNANCE CORPORATE GOVERNANCE

- Three constituents of Corporate Governance are **Shareholders, Board of Directors** and **Management.**
- **Management** has greatest responsibility for introducing good Corporate Governance.
- But primary responsibility for good governance rest with Board of Directors

How the business corporations are directed and controlled under Indian Company Law

- Private Limited Company
- Public Limited Company
- Holding and Subsidiary Companies
- Listed Company
- Government Company
- Foreign Company
- Non-profit Organisation (Section 25)

Conditions for Listing Stocks

- Satisfy Listing Agreement conditions.
- Promoters quota upto 75% for each security.
- Minimum issued capital Rs. 3 crores, out of which Rs. 1.80 crores is public offer (Bombay Stock Exchange Stock Exchange – Rs. 10 crores).
- Name – “Limited”, “Private Limited”.
- Memorandum of Association
- Articles Of Association

- Certificate of Incorporation
- Commencement of Business

CAPITAL

- Authorised Capital
- Subscribed Capital
- Paid-up Capital

SHARE CAPITAL
OF THE COMPANY

CLASSES OF SHARES (Stocks)

- Preference Shares – what are rights?
- Equity Shares – what are rights?
- Stockholders liability limited to Stockholders liability limited to face value of stocks. face value of stocks.
- Company's liability is unlimited. Company's liability is unlimited.

Two Methods of becoming Shareholder

- By purchase in primary market By purchase in primary market.
- By purchase in secondary market By purchase in secondary market.

Powers of the Company Powers of the Company

- Powers distributed between Powers distributed between
  i) Stockholders and
  ii) Board of Directors

- Stockholders: specifically listed

Board of Directors: residual powers

Major Powers of Shareholders

- Change of name, MOA & AOA
- Issue of Stock at discount
- Approval of Accounts & Dividend
- Appointment of Directors & Auditors
- Remuneration of MD and executive Directors
- Sale of Manufacturing Facilities
- Approval of borrowing powers of Directors
- Contribution to charitable purposes
- Winding up of Company
- Buy back of shares
- Issue of stocks to outsiders
- Reduction of Share Capital
- Payment of commission to Directors
- Amalgamation or Merger

How Shareholders decide

- Through:

i) Annual General Meeting (AGM)

ii) Extraordinary General Meeting (EGM)

- Notice of Meeting

Resolutions

Decisions by:

- Ordinary Resolutions
- Special Resolutions

Voting

- By show of hands– one vote one vote
- By Ballot– voting right prorata to Capital
- When Ballot?
- By Postal Ballot

Board of Directors – Legal Board

- Minimum number of Directors
- Legal position of Directors
- Directors as Agents
- Directors as Trustees
- Directors as Employees

Board of Directors

- Whole-time Directors:
  - Managing Directors
  - Executive Directors

- Non whole-time Directors (outside Directors)
  - Independent Directors
  - Other Directors
  - Nominee Directors

Managing Director and Executive Director

Definition:

- Managing Director - When mandatory

  - Duration

  - Remuneration

Board of Management or Management

- Not mandatory, comprises:
  Managing Director
  Executive Directors
  Company Secretary
  President
  Division heads
  Other Senior executives reporting to Board

Company Secretary

- When Mandatory– Rs. 2 crores limit

DIRECTORS REMUNERATION

• Approval Procedure, Statutory limits
• Total 11% of net profit
• All Executive Directors – 10%
• Per Executive Director – 5%

• Other Directors – 3% or 1%

• Satisfy conditions of Schedule XIII, if net profit is inadequate.

APPOINTMENT OF DIRECTORS

(A) BY THE ARTICLES / BY SUBSCRIBING TO MEMORANDUM

(B) BY STOCKHOLDERS IN GENERAL MEETING

(C) BY BOARD OF DIRECTORS.

(D) BY CENTRAL GOVERNMENT

(E) BY THIRD PARTIES

FIRST DIRECTORS by Articles

BY SHAREHOLDERS

- Two-third by Stockholders
  - Subject to retire by rotation
- One-third by Promoters

APPOINTMENT BY THE BOARD

(A) APPOINT ADDITIONAL DIRECTORS;

(B) APPOINT ALTERNATE DIRECTORS;

(C) FILL UP CASUAL VACANCIES;

APPOINTMENT BY CENTRAL GOVT.;

APPOINTMENT BY THIRD PARTIES (Nominee Directors)

- **Board Meetings**

- **Number of Board Meetings**

- **Notice of Board Meetings**

- **Quorum at Board Meetings**

- **Procedure of Board Meetings**

- **General power vested in the Board**
- **Delegation of Powers**
- **Powers to be exercised only at Board Meetings**
- **Powers subject to the consent of Stockholders**
- **Number of Directorships**

Disqualification of Directors – Section 274

- He is found to be of unsound mind
- He is an undischarged insolvent
- He has applied to be adjudicated as insolvent
- He has been convicted by Court
- He has not paid the calls on Shares of the Company

Director of Public Company disqualified from appointment as a Director for a period of 5 years, if **–**

- defaulted filing Annual Accounts and Annual Reports for 3 years.
- defaulted in paying deposits with interest or redeem Debentures pay dividend, for more than 1 year.

Enforceable Rules of Corporate Governance

- **Companies Act** and **Kumarmangalam Birla Report** (Listing Agreement) lay down mandatory provisions of corporate governance in India.

Importance of Report of Kumarmangalam Birla Committee on Corporate Governance (Birla Report)

- Today in India separate code of Corporate Governance mean Birla Report.
- Birla Committee was appointed by SEBI and its Report accepted and implemented through amendment to Listing Agreement
- Listing Agreements (Birla Report) is binding only on Listed Companies.

Rules of Corporate Governance under the Companies Act

- The law which lays down rules of Corporate Governance for all companies whether listed or not, is Companies Act, 1956, as amended, Companies (Amendment) Act, 2000.

Objects

- Objects of the rules of Corporate Governance under the Companies Act:
- Transparency in Management
- Accountability of Board of Directors Accountability of Board of Directors
- Promote and protect interest of Shareholders

1. Directors Responsibility Statement – Section 217

"Directors Responsibility Statement" to be included in Report of Board of Directors.

Major contents:

i) Applicable Accounting Standards followed for annual accounts.

ii) Directors taken care to secure true and fair view of state of affairs.

iii) Sufficient care taken for maintenance of accounting records, safeguarding assets and preventing fraud.

2. Disqualification for Auditor – Section 226

Persons not Qualified for appointment as Auditors:

- A body corporate
- An officer or employee of the Company
- A Partner or employee of an officer of the Company
- A Person indebted to the Company
- A Person holding security with voting rights disqualified from as auditor. One year given for compliance to affected Auditors.
- No such Provision in Birla Report.

3. Reduction of Maximum Directorship

Limit of 20 reduced to 15.

Audit Committee – Section 292A

- Mandatory for all public companies with paid up capital of not less than 5 crores.
- Audit Committee is a Committee of Board – not less than 3 Directors. Two-thirds must be Non-Executive Directors.
- Annual Report to disclose the composition of Audit Committee.

4. Audit Committee – Section 292A

- Audit Committee to discuss with auditors about internal control systems, scope of audit, review half yearly and annual financial statements before half yearly and annual financial statements before sending to Board and compliance of internal control systems.
- Audit Committee entitled to investigate any matter referred to by Board and will have full access to information.
- Report of Audit Committee is binding on the Board.
- Audit Committee will appoint Chairman who will have right to attend shareholder meetings.
- If default is made, it is punishable with imprisonment up to one year or with fine of Rs.50,000/ or with both.

5. Compliance Certificate
– Section 383(A)

- Company with paid up capital of more than Rs.10 lakhs but less than Rs.2 crores not bound to employ full time Company Secretary is now subject to Legal Audit by practicing Company Secretary.

6. Small Depositors Special Protection

- Small Deposit is a deposit of Rs.20,000/- in a financial year.
- Company to intimate to CLB within 60 days upon default and it passes order in 30 days.
- Cognizable offence and disqualified from accepting further deposits from small depositors.
- All future advertisements to contain details of default.

7. Postal Ballot

- **Applicable only to public companies.**
- **Important items listed for Postal Ballot**

  i. Alteration to MOA and AOA
  ii. Buy back of shares
  iii. Issue of shares with differential rights
  iv. Sale of undertaking manufacturing facility
  v. Corporate Loans in excess of Section 372A

- Company also has option of Postal Ballot for other business.

Major rules of Governance for Board

- Meet at least 4 times in a year.
- Powers of Board under Section 291 is subject to limitation:
  - All decisions should be in accordance with MOA and AA.
- Attendance at Board meeting is mandatory
  - Three consecutive default will disqualify as Director.

- Disclosure of interest in all transactions for avoidance of conflict of interest.
- Disclosure of material facts in any resolution to be passed at General meetings.
- Disclosure of shares held by Directors.
- Restrictions on holding of place of profit.

➢ Certain powers to be exercised only at Board meeting:

- Power to make calls on Shares
- Power to authorize buy-back of Shares
- Power to issue Debentures
- Power to borrow money
- Power to invest Company's funds
- Power to make loans

➢ Company Law also enjoins several duties on Directors. Some of them:

- Duty of care and skill in discharge of functions.
- Duty to take a decision in best interest of Company though it is against his personal interest.
- Duty of confidentiality
- Duty not to make secret profits.
- Duty not to compete with the Company

<u>Powers to be exercised only with approval of Shareholders</u>

- Sell, lease or dispose off production units of the Company

- Remit or give time for repayment of debt by a Director
- Borrow money beyond prescribed limit
- Contribute to funds not related to the business of the Company

Disclosures to Investors and Public

❖ Documents available to Public for inspection:

- Memorandum and Articles of Association
- Annual Accounts
- Annual Returns
- Changes in the Board of Directors
- Changes in the Constitutional Documents:
  - Memorandum & Articles of Association

Audit Accounts

Accounts should be signed by two Directors and MD should be one of them.

Additional Rules of Corporate Governance applicable only to Listed Companies – Birla Report.

1. Composition of Board of Directors

- Three Categories of Directors –

i. Executive Directors including M.D
ii. Non-Executive Directors
iii. Independent Directors.

- Independent Directors is one who does not have material or pecuniary relationship with Company or related persons, except sitting fees.

2. Ratio of Non-Executive and Independent Directors

- Non-Executive Directors not less than 50% when Chairman is Non-Executive and not less than one-third Independent Director.
- When Chairman is Executive Director, 50% should be independent.

3. Also there is provision for appointment of:

- Shareholders/Investors Grievance Committee.
- Remuneration committee.
- Corporate Governance report in Annual Report. No such provision in Companies Act.

4. The Board must also make:

"Management discussions and Analysis Report" as a part of Annual Report to Shareholders. The main contents –

i. Opportunities and Threats.
ii. Segment wise and Product wise performance.
iii. Risk and concern.
iv. Information about Human Resources and Industrial Relations.

Corporate Governance as practiced by Indian Boards

- Practice is very different from Law.
- The Boards can be classified as under:

1) The Puppet Board

- No functional role, except legalizing the proceedings.
- Mostly family owned or wholly owned subsidiary.
- Either the family or holding company takes decision and Board only ratifies.
- Many times Directors are shareholders (Closely held Company) no distinction between meetings of Shareholders or Directors.

2) Drifting Board - Controlled by Professional Managers

- MD is Chief and Chairman rely heavily on him
- Shareholders control is low and also Board control is low
- Meetings take place not for arriving at a decision but to confirm decision already taken. The Board only reacts to the proposal and seldom proactive.

3) The Partnership Board

- Shareholder control is high and Board control is high. There is a mutual respect control for each others authority.
- Discussions are frank and open.
- The objective is maximizing long term shareholder value.

4) Autonomous Board

- Enjoys autonomy because of widely distributed and small shareholders.
- Shareholder control is low and Board control is high. Managing Director assumes role of entrepreneur.

- Shareholders have limited say in the matter and are remembered only at the time of threat of hostile takeover.

Realities of Indian Board

- Truly independent Directors are a rare bread
- Non-Executive Directors are less than a third of total Directors in most Companies. They comprise family members or recently retired Company officials, lawyers and C.A.'s.
- In many cases agenda papers delivered to Directors too late or at Board Meetings. Many times incomplete or short.
- Rarely Board Meetings last more than half an hour. No doubt followed with sumptuous lunch. Many times in 5 Star Hotels.
- In many cases Management makes sure that outside Directors are docile or do not interfere through diplomatic selection and by not giving them sufficient information.
- Only matters requiring legal approval comes to Legal Board for rubber stamp.
- Business transacted never matches with the agenda. Most of important items slipped under omnibus item "other business with the permission of the Chair."
- Agenda sent without explanatory note or relevant documents, they are given only at the meeting.
- Sometimes meeting held with only 24 hours notice or without written notice. (No provision under the law for length of the notice)

How can we change the present practice and improve the Corporate Governance in India

- Number of Non-Executive Directors should be increased.

- They should be encouraged to assert their right. Today they are passive and inactive, nor they have time.
- Non-Executive Directors should be made accountable for the decisions taken by Board and for the affairs of the Company
- Board should meet at least once a month to be effective and Directors should attend most of the meetings.
- There should be structured performance appraisal of Managing Director and other Executive Directors by a Committee of the Board.
- In India Shareholders never make the Board accountable for the performance of the Company. Both Executive and Non-Executive Directors should pay for the failure to meet the goals of Company.
- No law can imbibe ethics in unwilling Board. Law cannot be substituted for code of best practices, it can only supplement and support as it is sought to be done by Companies Act.

Listing Agreement of Bombay Stock Exchange

Clause 49 deals with the provisions of Corporate Governance which is as under:

- **Clause 49 - Corporate Governance**

The company agrees to comply with the following provisions:

- **Board of Directors**

Composition of Board:

(i) The board of directors of the company shall have an optimum combination of executive and non-executive directors with not less than fifty percent of the board of directors comprising of non-executive directors. The number of independent directors would depend on whether the Chairman is executive or non-executive. In case of a non-executive chairman, at least one-third of board should comprise of independent directors and in case of an executive chairman, at least half of board should comprise of independent directors.

Explanation (i): For the purpose of this clause, the expression 'independent director' shall mean non-executive director of the company who:

a. apart from receiving director's remuneration, does not have any material pecuniary relationships or transactions with the company, its promoters, its senior management or its holding company, its subsidiaries and associated companies;

b. is not related to promoters or management at the board level or at one level below the board;

c. has not been an executive of the company in the immediately preceding three financial years;

d. is not a partner or an executive of the statutory audit firm or the internal audit firm that is associated with the company, and has not been a partner or an executive of any such firm for the last three years. This will also apply to legal firm(s) and consulting firm(s) that have a material association with the entity.

e. is not a supplier, service provider or customer of the company. This should include lessor-lessee type relationships also; and

f. is not a substantial shareholder of the company, i.e. owning two percent or more of the block of voting shares.

Explanation (ii): Institutional directors on the boards of companies shall be considered as independent directors whether the institution is an investing institution or a lending institution.

Non executive directors' compensation and disclosures:

(i) All compensation paid to non-executive directors shall be fixed by the Board of Directors and shall be approved by shareholders in general meeting. Limits shall be set for the maximum number of stock options that can be granted to non-executive directors in any financial year and in aggregate. The stock options granted to the non-executive directors shall vest after a period of at least one year from the date such non-executive directors have retired from the Board of the Company.

(ii) The considerations as regards compensation paid to an independent director shall be the same as those applied to a non-executive director.

(iii) The company shall publish its compensation philosophy and statement of entitled compensation in respect of non-executive directors in its annual report. Alternatively, this may be put up on the company's website and reference drawn thereto in the annual report. Company shall disclose on an annual basis, details of shares held by non-executive directors, including on an "if-converted" basis.

(iv) Non-executive directors shall be required to disclose their stock holding (both own or held by / for other persons on a beneficial basis) in the listed company in which they are proposed to be appointed as directors, prior to their appointment. These details should accompany their notice of appointment

Independent Director

(i) Independent Director shall however periodically review legal compliance reports prepared by the company as well as steps taken by the company to cure any taint. In the event of any proceedings against an independent director in connection with the affairs of the company, defense shall not be permitted on the ground that the independent director was unaware of this responsibility.

(ii) The considerations as regards remuneration paid to an independent director shall be the same as those applied to a non executive director

Board Procedure

(i) The board meeting shall be held at least four times a year, with a maximum time gap of four months between any two meetings. The minimum information to be made available to the board is given in Annexure-IA.

(ii) A director shall not be a member in more than 10 committees or act as Chairman of more than five committees across all companies in which he is a director. Furthermore it should be a mandatory annual requirement for every director to inform the company about the committee positions he occupies in other companies and notify changes as and when they take place.

Explanation: For the purpose of considering the limit of the committees on which a director can serve, all public limited companies, whether listed or not, shall be included and all other companies (i e private limited companies, foreign companies and companies under Section 25 of the Companies Act, etc) shall be excluded.

(iii) Further only the three committees viz. the Audit Committee, the Shareholders' Grievance Committee and the Remuneration Committee shall be considered for this purpose.

Code of Conduct

(i) It shall be obligatory for the Board of a company to lay down the code of conduct for all Board members and senior management of a company. This code of conduct shall be posted on the website of the company.

(ii) 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.

Explanation: For this purpose, the term "senior management" shall mean personnel of the company who are members of its management / operating council (i.e. core management team excluding Board of Directors). Normally, this would comprise all members of management one level below the executive directors

Term of Office of Non-executive Directors

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

Audit Committee

Qualified and Independent Audit Committee

A qualified and independent audit committee shall be set up and shall comply with the following:

(i) The audit committee shall have minimum three members. All the members of audit committee shall be non-executive directors, with the majority of them being independent.

(ii) All members of audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise.

Explanation (i):The term "financially literate" means the ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows.

Explanation (ii): A member will be considered to have accounting or related financial management expertise if he or she possesses experience in finance or accounting, or requisite professional certification in accounting, or any other comparable experience or background which results in the individual's financial sophistication, including being or having been a chief executive officer, chief financial officer, or other senior officer with financial oversight responsibilities.

(iii) The Chairman of the Committee shall be an independent director;

(iv) The Chairman shall be present at Annual General Meeting to answer shareholder queries;

(v) The audit committee should invite such of the executives, as it considers appropriate (and particularly the head of the finance function) to be present at the meetings of the committee, but on occasions it may also meet without the presence of any executives of the company. The finance director, head of internal audit and when required, a representative of the external auditor shall be present as invitees for the meetings of the audit committee;

(vi) The Company Secretary shall act as the secretary to the committee.

Meeting of Audit Committee

The audit committee shall meet at least thrice a year. One meeting shall be held before finalization of annual accounts and one every six months. The quorum shall be either two members or one third of the members of the audit committee, whichever is higher and minimum of two independent directors.

Powers of Audit Committee

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

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

(ii) To seek information from any employee.

(iii) To obtain outside legal or other professional advice.

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

Role of Audit Committee

(i) The role of the audit committee shall include the following:

1. Oversight of the company's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.
2. Recommending the appointment and removal of external auditor, fixation of audit fee and also approval for payment for any other services.

3. Reviewing with management the annual financial statements before submission to the board, focusing primarily on;

a. Any changes in accounting policies and practices.

b. Major accounting entries based on exercise of judgment by management.

c. Qualifications in draft audit report.

d. Significant adjustments arising out of audit.

e. The going concern assumption.

f. Compliance with accounting standards.

g. Compliance with stock exchange and legal requirements concerning financial statements

h. Any related party transactions

4. Reviewing with the management, external and internal auditors, the adequacy of internal control systems.

5. Reviewing the adequacy of internal audit function, including the structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure coverage and frequency of internal audit.

6. Discussion with internal auditors any significant findings and follow up there on.

7. Reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure

of internal control systems of a material nature and reporting the matter to the board.

8. Discussion with external auditors before the audit commences about nature and scope of audit as well as post-audit discussion to ascertain any area of concern.

9. Reviewing the company's financial and risk management policies.

10. To look into the reasons for substantial defaults in the payment to the depositors, debenture holders, shareholders (in case of non payment of declared dividends) and creditors.

Explanation (i): The term "related party transactions" shall have the same meaning as contained in the Accounting Standard 18, Related Party Transactions, issued by The Institute of Chartered Accountants of India.

Explanation (ii): If the company has set up an audit committee pursuant to provision of the Companies Act, the company agrees that the said audit committee shall have such additional functions / features as is contained in the Listing Agreement.

Review of information by Audit Committee

(i) The Audit Committee shall mandatorily review the following information:

1. Financial statements and draft audit report, including quarterly / half-yearly financial information;

2. Management discussion and analysis of financial condition and results of operations;

3. Reports relating to compliance with laws and to risk management;

4. Management letters / letters of internal control weaknesses issued by statutory / internal auditors; and

5. Records of related party transactions

6. The appointment, removal and terms of remuneration of the Chief internal auditor shall be subject to review by the Audit Committee

Audit Reports and Audit Qualifications

Disclosure of Accounting Treatment

In case it has followed a treatment different from that prescribed in an Accounting Standards, management shall justify why they believe such alternative treatment is more representative of the underlined business transactions. Management shall also clearly explain the alternative accounting treatment in the footnote of financial statements.

Whistle Blower Policy

Internal Policy on access to Audit Committees:

(i) Personnel who observe an unethical or improper practice (not necessarily a violation of law) shall be able to approach the audit committee without necessarily informing their supervisors.

(ii) Companies shall take measures to ensure that this right of access is communicated to all employees through means of internal circulars, etc. The employment and other personnel policies of the company shall contain provisions protecting "whistle blowers" from unfair termination and other unfair prejudicial employment practices.

(iii) Company shall annually affirm that it has not denied any personnel access to the audit committee of the company (in respect of matters involving alleged misconduct) and that it has provided protection to "whistle blowers" from unfair termination and other unfair or prejudicial employment practices.

(iv) Such affirmation shall form a part of the Board report on Corporate Governance that is required to be prepared and submitted together with the annual report.

(v) The appointment, removal and terms of remuneration of the chief internal auditor shall be subject to review by the Audit Committee.

V. Subsidiary Companies

The company agrees that provisions relating to the composition of the Board of Directors of the holding company shall be made applicable to the composition of the Board of Directors of subsidiary companies

At least one independent director on the Board of Directors of the holding company shall be a director on the Board of Directors of the subsidiary company.

The Audit Committee of the holding company shall also review the financial statements, in particular the investments made by the subsidiary company.
The minutes of the Board meetings of the subsidiary company shall be placed for review at the Board meeting of the holding company.

The Board report of the holding company should state that they have reviewed the affairs of the subsidiary company also

VI. Disclosure of contingent liabilities

The company agrees that management shall provide a clear description in plain English of each material contingent liability and its risks, which shall be accompanied by the auditor's clearly worded comments on the management's view. This section shall be highlighted in the significant accounting policies and notes on accounts, as well as, in the auditor's report, where necessary.

VII. Disclosures

Basis of related party transactions

(i) A statement of all transactions with related parties including their basis shall be placed before the Audit Committee for formal approval/ratification. If any transaction is not on an arm's length basis, management shall provide an explanation to the Audit Committee justifying the same.

Board Disclosures -Risk management

(i) It shall put in place procedures to inform Board members about the risk assessment and minimization procedures. These procedures shall be periodically reviewed to ensure that executive management controls risk through means of a properly defined framework.

(ii) Management shall place a report certified by the compliance officer of the company, before the entire Board of Directors every quarter documenting the business risks faced by the company, measures to address and minimize such risks, and any limitations to the risk taking capacity of the corporation. This document shall be formally approved by the Board.

Proceeds from Initial Public Offerings (IPOs)

(i) When money is raised through an Initial Public Offering (IPO) it shall disclose to the Audit Committee, the uses / applications of funds by major category (capital expenditure, sales and marketing, working capital, etc), on a quarterly basis as a part of their quarterly declaration of financial results. Further, on an annual basis, the company shall prepare a statement of funds utilized for purposes other than those stated in the offer document/prospectus. This statement shall be certified by the independent auditors of the company. The audit committee shall make appropriate recommendations to the Board to take up steps in this matter.

Remuneration of Directors

a. All pecuniary relationship or transactions of the non-executive director's vis-à-vis the company shall be disclosed in the Annual Report.

(i) Further the following disclosures on the remuneration of directors shall be made in the section on the corporate governance of the annual report.

a. All elements of remuneration package of all the directors i.e. salary, benefits, bonuses, stock options, pension etc.

b. Details of fixed component and performance linked incentives, along with the performance criteria.

c. Service contracts, notice period, severance fees.

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

Management

(i) As part of the directors' report or as an addition there to, a Management Discussion and Analysis report should form part of the annual report to the shareholders. This Management Discussion & Analysis should include discussion on the following matters within the limits set by the company's competitive position:

a. Industry structure and developments.

b. Opportunities and Threats.

c. Segment-wise or product-wise performance.

d. Outlook

e. Risks and concerns.

f. Internal control systems and their adequacy.

g. Discussion on financial performance with respect to operational performance.

h. Material developments in Human Resources / Industrial Relations front, including number of people employed.

Management shall make disclosures to the board relating to all material financial and commercial transactions, where they have personal interest, that may have a potential conflict with the interest of the company at large (for e.g. dealing in company shares, commercial dealings with bodies, which have shareholding of management and their relatives etc.)

Shareholders

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

a. A brief resume of the director;
b. Nature of his expertise in specific functional areas ; and

c. Names of companies in which the person also holds the directorship and the membership of Committees of the board.

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

(iii) A board committee under the chairmanship of a non-executive director shall be formed to specifically look into the redressal of shareholder and investors complaints like transfer of shares, non-receipt of balance sheet, non-receipt of declared dividends etc. This Committee shall be designated as 'Shareholders/Investors Grievance Committee'.

(iv) To expedite the process of share transfers the board of the company shall delegate the power of share transfer to an officer or a committee or to the registrar and share transfer agents. The delegated authority shall attend to share transfer formalities at least once in a fortnight.

VIII. CEO/CFO certification

CEO (either the Executive Chairman or the Managing Director) and the CFO (whole-time Finance Director or other person discharging this function) of the company shall certify that, to the best of their knowledge and belief:

a. They have reviewed the balance sheet and profit and loss account and all its schedules and notes on accounts, as well as the cash flow statements and the Directors' Report;

b. These statements do not contain any materially untrue statement or omit any material fact nor do they contain statements that might be misleading;

c. These statements together present a true and fair view of the company, and are in compliance with the existing accounting standards and / or applicable laws / regulations;

d. They are responsible for establishing and maintaining internal controls and have evaluated the effectiveness of internal control systems of the company; and they have also disclosed to the auditors and the Audit Committee, deficiencies in the design or operation of internal controls, if any, and what they have done or propose to do to rectify these;

e. They have also disclosed to the auditors as well as the Audit Committee, instances of significant fraud, if any, that involves management or employees having a significant role in the company's internal control systems; and

f. They have indicated to the auditors, the Audit Committee and in the notes on accounts, whether or not there were significant changes in internal control and / or of accounting policies during the year.

IX. Report on Corporate Governance

There shall be a separate section on Corporate Governance in the annual reports of company, with a detailed compliance report on Corporate Governance. Non-compliance of any mandatory requirement i.e. which is part of the listing agreement with reasons thereof and the extent to which the non-mandatory requirements have been adopted should be specifically highlighted. The suggested list of items to be included in this report is given in Annexure-1B and list of non-mandatory requirements is given in Annexure -1C.
The companies shall submit a quarterly compliance report to the stock exchanges within 15 days from the close of quarter as per the format given below. The report shall be submitted either by the Compliance Officer or the Chief Executive Officer of the company after obtaining due approvals.

Format of Quarterly Compliance Report on Corporate Governance
Name of the Company:
Quarter ending on:

Particulars	**Clause of Listing Agreement**	**Compliance status (Yes/No/N.A.)**	**Remarks**
1	**2**	**3**	**4**
I. Board of Directors	49 I		
(A)Composition of Board	49(IA)		
(B)Non-executive Directors' compensation & disclosures	(IB)		
(C)Independent Director	(IC)		
(D)Board Procedure	9 (ID)		
(E)Code of Conduct	9 (IE)		
(F)Term of office of non-executive directors	49 (IF)		
II. Audit Committee	9 (II)		
(A)Qualified & Independent Audit Committee	9 (IIA)		
(B)Meeting of Audit Committee	9 (IIB)		
(C)Powers of Audit Committee	9 (IIC)		
(D)Role of Audit Committee	II(D)		
(E)Review of Information by Audit Committee	49 (IIE)		
III. Audit Reports and Audit Qualifications	49 (III)		
IV.Whistle Blower Policy	49 (IV)		
V. Subsidiary Companies	49 (V)		
VI. Disclosure of contingent liabilities	49 (VI)		
VII.Disclosures	49 (VII)		

(A)Basis of related party transactions	IIA)		
(B)Board Disclosures	(VIIB)		
(C)Proceeds from Initial Public offerings	49 (VIIC)		
(D)Remuneration of Directors	49 (VIID)		
(E)Management	(VIIE)		
(F)Shareholders	49 (VIIF)		
VIII.CEO/CFO Certification	49 (VIII)		
IX. Report on Corporate Governance	49 (IX)		
X. Compliance	49 (X)		

Note:

1) The details under each head shall be provided to incorporate all the information required as per the provisions of the clause 49 of the Listing Agreement.

2) In the column No.3, compliance or non-compliance may be indicated by Yes/No/N.A.. For example, if the Board has been composed in accordance with the clause 49 I of the Listing Agreement, "Yes" may be indicated. Similarly, in case the company has not come out with an IPO, the words "N.A." may be indicated against 49 (VIIC).

3) In the remarks column, reasons for non-compliance may be indicated, for example, in case of requirement related to circulation of information to the shareholders, which would be done only in the AGM/EGM, it might be indicated in the "Remarks" column as – "will be complied with at the AGM". Similarly, in respect of matters which can be complied with only where the

situation arises, for example, "Report on Corporate Governance" is to be a part of Annual Report only, the words "will be complied in the next Annual Report" may be indicated.

X. Compliance

The company shall obtain a certificate from either the auditors or practicing company secretaries regarding compliance of conditions of corporate governance as stipulated in this clause and annex the certificate with the directors' report, which is sent annually to all the shareholders of the company. The same certificate shall also be sent to the Stock Exchanges along with the annual returns filed by the company.

Schedule of implementation

(1) The provisions of the revised clause 49 shall be implemented as per the schedule of implementation given below:

(i) By all entities seeking listing for the first time, at the time of listing.

(ii) By all companies which were required to comply with the requirement of the erstwhile clause 49 i.e. all 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 entity . These entities shall be required to comply with the requirement of this clause on or before March 31, 2004.

(2) The non-mandatory requirement given in Annexure – 1C shall be implemented as per the discretion of the company. However, the disclosures of the adoption/non-adoption of the non-mandatory requirements shall be made in the section on corporate governance of the Annual Report.

Annexure 1A

Information to be placed before Board of Directors

1. Annual operating plans and budgets and any updates.

2. Capital budgets and any updates.

3. Quarterly results for the company and its operating divisions or business segments.

4. Minutes of meetings of audit committee and other committees of the board.

5. The information on recruitment and remuneration of senior officers just below the board level, including appointment or removal of Chief Financial Officer and the Company Secretary.

6. Show cause, demand, prosecution notices and penalty notices which are materially important

7. Fatal or serious accidents, dangerous occurrences, any material effluent or pollution problems.

8. Any material default in financial obligations to and by the company, or substantial non-payment for goods sold by the company.

9. Any issue, which involves possible public or product liability claims of substantial nature, including any judgement or order which, may have passed strictures on the conduct of the company or taken an adverse view regarding another enterprise that can have negative implications on the company.

10. Details of any joint venture or collaboration agreement.

11. Transactions that involve substantial payment towards goodwill, brand equity, or intellectual property.

12. Significant labour problems and their proposed solutions. Any significant development in Human Resources/ Industrial Relations front like signing of wage agreement, implementation of Voluntary Retirement Scheme etc.

13. Sale of material nature, of investments, subsidiaries, assets, which is not in normal course of business.

14. Quarterly details of foreign exchange exposures and the steps taken by management to limit the risks of adverse exchange rate movement, if material.

15. Non-compliance of any regulatory, statutory nature or listing requirements and shareholders service such as non-payment of dividend, delay in share transfer etc.

Annexure 1B

Suggested List of Items to Be Included In the Report on Corporate Governance in the Annual Report of Companies

A brief statement on company's philosophy on code of governance.

Board of Directors:

(i) Composition and category of directors, for example, promoter, executive, non- executive, independent non-executive, nominee director, which institution represented as lender or as equity investor.

(ii) Attendance of each director at the BoD meetings and the last AGM.

(iii) Number of other BoDs or Board Committees in which he/she is a member or Chairperson

(iv) Number of BoD meetings held, dates on which held.

3. Audit Committee.

(i) Brief description of terms of reference

(ii) Composition, name of members and Chairperson

(iii) Meetings and attendance during the year

4. Remuneration Committee.

(i) Brief description of terms of reference

(ii) Composition, name of members and Chairperson

(iii) Attendance during the year

(iv) Remuneration policy

(v) Details of remuneration to all the directors, as per format in main report.

5. Shareholders Committee

(i) Name of non-executive director heading the committee

(ii) Name and designation of compliance officer

(iii) Number of shareholders' complaints received so far

(iv) Number not solved to the satisfaction of shareholders

(v) Number of pending complaints

6. General Body Meetings

(i) Location and time, where last three AGMs held.

(ii) Whether any special resolutions passed in the previous 3 AGMs

(iii) Whether any special resolution passed last year through postal ballot – details of voting pattern

(iv) Person who conducted the postal ballot exercise

(v) Whether any special resolution is proposed to be conducted through postal ballot

(vi) Procedure for postal ballot

7. Disclosures

(i) Disclosures on materially significant related party transactions that may have potential conflict with the interests of company at large.

(ii) Disclosure of accounting treatment, if different, from that prescribed in Accounting standards with explanation.

(iii) Details of non-compliance by the company, penalties, strictures imposed on the company by Stock Exchange or SEBI or any statutory authority, on any matter related to capital markets, during the last three years.

(iv) Whistle Blower policy and affirmation that no personnel has been denied access to the audit committee.

8. Means of communication

(i) Half-yearly report sent to each household of shareholders.

(ii) Quarterly results

(iii) Newspapers wherein results normally published

(iv) Any website, where displayed

(v) Whether it also displays official news releases; and

(vi) The presentations made to institutional investors or to the analysts.

(vii) Whether MD&A is a part of annual report or not.

9. General Shareholder information

(i) AGM : Date, time and venue

(ii) Financial Calendar

(iii) Date of Book closure

(iv) Dividend Payment Date

(v) Listing on Stock Exchanges

(vi) Stock Code

(vii) Market Price Data: High, Low during each month in last financial year

(viii) Performance in comparison to broad-based indices such as BSE Sensex, CRISIL index etc.

(ix) Registrar and Transfer Agents

(x) Share Transfer System

(xi) Distribution of shareholding

(xii) Dematerialization of shares and liquidity

(xiii) Outstanding GDRs/ADRs/Warrants or any Convertible instruments, conversion date and likely impact on equity

(xiv) Plant Locations

(xv) Address for correspondence

Annexure 1C

Non-Mandatory Requirements

(1) Chairman of the Board

A non-executive Chairman should be entitled to maintain a Chairman's office at the company's expense and also allowed reimbursement of expenses incurred in performance of his duties.

(2) Remuneration Committee

(i) The board should set up a remuneration committee to determine on their behalf and on behalf of the shareholders with agreed terms of reference, the company's policy on specific remuneration packages for executive directors including pension rights and any compensation payment.

(ii) To avoid conflicts of interest, the remuneration committee, which would determine the remuneration packages of the executive directors should comprise of at least three directors, all of whom should be non-executive directors, the chairman of committee being an independent director.

(iii) All the members of the remuneration committee should be present at the meeting.

(iv) The Chairman of the remuneration committee should be present at the Annual General Meeting, to answer the shareholder queries. However, it would be up to the Chairman to decide who should answer the queries.

Shareholder Rights

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

Postal Ballot

Currently, though there is requirement for holding the general meeting of shareholders, in actual practice only a small fraction of the shareholders of that company do or can really participate therein. This virtually makes the concept of corporate democracy illusory. It is imperative that this situation which has lasted too long needs an early correction. In this context, for shareholders who are unable to attend the meetings, there should be a requirement which will enable them to vote by postal ballot for key decisions. Some of the critical matters which should be decided by postal ballot are given below:

(i) Matters relating to alteration in the memorandum of association of the company like changes in name, objects, address of registered office etc;

(ii) Sale of whole or substantially the whole of the undertaking;

Sale of investments in the companies, where the shareholding or the voting rights of the company exceeds 25%;

Making a further issue of shares through preferential allotment or private placement basis;

Corporate restructuring;

Entering a new business area not germane to the existing business of the company;

Variation in rights attached to class of securities;

Matters relating to change in management

(5) Audit qualifications

Company may move towards a regime of unqualified financial statements.

(6) Training of Board Members

Company shall train its Board members in the business model of the company as well as the risk profile of the business parameters of the company, their responsibilities as directors, and the best ways to discharge them.

(7) Mechanism for evaluating non-executive Board Members

The performance evaluation of non-executive directors should be done by a peer group comprising the entire Board of Directors, excluding the director being evaluated; and Peer Group evaluation should be the mechanism to determine whether to extend / continue the terms of appointment of non-executive directors.

Role of Management

Non-legal part of Corporate Governance

We have already seen who is the "Management"

What is Corporate Governance for the Management?

- Guide the Board to create a dynamic code of best management practice which provides:
  - Transparency
  - Accountability
  - Create long term objectives/ mission
  -

Professional Management

It is the responsibility of the Management to introduce professional management and create Professional Managers.

What is Professional Management?

- Accountability
- Transparency
- Ethical Management
- Interest of various Shareholders
- Propertyless Managers
- But all focused on business results and mission

Most important role of Management is to create
Long Term objectives/ Mission

- Foundation of Corporate Governance is the Corporate Mission.
- Primary task of Management is to create compelling Mission.

- It is the power of the mission that creates leaders who lead corporations to success.

"MISSION CREATES THE LEADER"

BY
DR. ABDUL KALAM

PRESIDENT OF INDIA &
FATHER OF THE INDIAN MISSILE TECHNOLOGY

The objectives Corporate Governance for the Management should be:

- to create leaders who would lead Company to achieve your mission and
- to create next generations of outstanding men and women to lead Company in this millennium.

Characteristics of Good Corporate Governance

- It should constantly prod management to challenge the status quo by asking basic questions and generating new alternatives:
- Should we be continuing the same activity?
- What value does this give to our customers?
- Should we do it differently?

One definition of insanity is to believe that you can keep doing what you've been doing and get different results.

Corporate Governance should promote positive change

- Success means positive change and continuous improvement.
- We must take risks in order to make change in the status quo. Risk means daring to change. Change means uncertainty. Uncertainty of success or failure is risk.
- We must create an environment that encourages risk taking.

Corporate Governance should create leaders, because it is -

- Leaders who lead your department / Organisation to achieve your mission
- Leaders who create followers
- Leaders who create leaders
- Leaders who create change

No manager will succeed unless he is leader.

Leaders v/s. Managers

- Leadership is different from management.
- Leaders always make changes.
- Managers run organizations/ changes.
- Managers tend to institutionalize “status quo”.
- Leaders go beyond these “status quo”.
- They found ways to create groups of followers, so they could together change things and meet goals.

Leadership

- Leadership is the process of getting other people voluntarily committed to meet commonly agreed objectives.
- Leadership means energizing people to act.

- It usually involves expressing the vision in a "story", which builds understanding and the desire for action in the followers.
- A great example of a "story" is John Kennedy's
  "Put a man on the moon and return him home safely by the end of the decade."
- This energized entire nation, its military and its industries. He stuck to the script, and even after his death the mission was accomplished.

SALIENT FEATURES OF COMBINED CODE

The Board of Directors

▪ Every company should be headed by an effective board, which is collectively responsible for the success of the company.

▪ All directors must take decisions objectively in the interests of the company.

Non- Executive Director:

▪ Non – executive directors should constructively challenge and help develop proposals on strategy.

▪Non – executive directors should scrutinize the performance of management in meeting agreed goals and objectives and monitor reporting of performance.

▪They should satisfy themselves on the integrity of financial information and that financial controls and systems of risk management are robust and defensible.

▪They are responsible for determining appropriate levels of remuneration of executive directors and have a prime role in appointing, and where necessary removing, executive directors, and decide succession planning.

Board Meetings

▪The Board should meet sufficiently regularly to discharge its duties effectively.

▪There should be a formal schedule of matters specifically reserved for its decision.

▪The annual report should include a statement of how the board operates, including a high level statement of which types of decisions are to be taken by the board and which are to be delegated to management.

Annual Report

▪The annual report should identify the chairman, the deputy chairman (where there is one), the chief executive, the senior independent director

▪All the chairmen and members of the nomination, audit and remuneration committees.

▪It should also set out the number of meetings of the board and those committees and individual attendance by directors.

Board Meeting …….

▪The chairman should hold meetings with the non – executive directors without the executives present.

▪Led by the senior independent director, the non – executive directors should meet without the chairman present at least annually to appraise the chairman’s performance.

▪Where directors have concerns, which cannot be resolved about the running of the company or a proposed action, they should ensure that their concerns are recorded in the board minutes.

▪On resignation, a non-executive director should provide a written statement to the Chairman, for circulation to the board, if he has any concerns.

▪The company should arrange appropriate insurance cover in respect of legal action against its directors.

Chairman and Chief Executive

▪There should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company's business.

▪No one individual should have unfettered powers of decision.

▪The chairman is responsible for leadership of the board, ensuring its effectiveness on all aspects of its role and setting its agenda.

▪Also responsible for ensuring that the directors receive accurate, timely and clear information.

▪Should ensure effective communication with shareholders.

▪Should also facilitate the effective contribution of non – executive directors in particular and ensure constructive relations between executive and non – executive directors.

▪The roles of chairman and chief executive should not be exercised by the same individual.

▪The division of responsibilities between the chairman and chief executive should be clearly established, set out in writing and agreed by the board.

▪The Chairman should meet the independence criteria.

▪A chief executive should not be Chairman of the same company.

▪If exceptionally a board decides that a chief executive should become chairman, the board should consult major shareholders in advance and should set out its reasons to shareholders at the time of the appointment and in the next annual report.

Board balance and Independence

▪The board should include a balance of executive and non – executive directors (and in particular independent non – executive directors) such that no individual or small group of individuals can dominate the board's decision taking.

▪The board should not be so large as to be unwieldy. The board should be sufficient size that the balance of skills and experience is appropriate for the requirements of the business.

▪Ensure that power and information are not concentrated in one or two individuals,

▪There should be a strong presence on the board of both executive and non – executive directors.

▪No one other than the committee chairman and members is entitled to be present at a meeting of the nomination, audit or remuneration committee, but others may attend at the invitation of the committee.

Independent Director

▪The board should identify in the annual report each non – executive director who is independent.

▪The board should determine whether the director is independent in character and judgment and whether there are relationships or circumstances which are likely to affect, or could appear to affect, the director's judgment.

Justification for Independent Director

- The board should state its reasons if it determines that a director is independent notwithstanding the existence of relationships or circumstances which may appear to affect his independence.

Some factors likely to affect independence of the Director

- has been an employee of the company or group within the last five years;
- has, or has had within the last three years, a material business relationship with the company either directly, or as a partner, shareholder director or senior employee of a body that has such a relationship with the company;
- has received or receives additional remuneration from the company apart from a director's fee, participates in the company's share option or a performance – related pay scheme, or is a member of the company's pension scheme;

Factors affecting independence of the Director……

- has close family ties with any of the company's advisers, directors or senior employees;
- holds cross – directorships or has significant links with other directors through involvement in other companies or bodies;
- represents a significant shareholder; or
- has served on the board for more than nine years from the date of their first election.

Senior Independent Director

▪Except for smaller companies, at least half the Board, excluding the Chairman, should comprise non – executive directors determined by the board to be independent.

▪A small company should have at least two independent non – executive directors.

▪The Board should appoint one of the independent non – executive directors to be the senior independent director.

▪The senior independent director should be available to shareholders if they have concerns, which they could not resolve through the normal channels of chairman, chief executive or finance director.

▪There should be formal, rigorous and transparent procedure for the appointment of new directors of the board.

▪Appointment to the board should be made on merit and against objective criteria.

▪Care should be taken to ensure that appointees have enough time available to devote to the job.

Nomination Committee

▪There should be a nomination committee which should lead the process for board appointments and make recommendations to the board.

▪A majority of members of the nomination committee should be independent none – executive directors.

▪The chairman or an independent non – executive director should chair the committee

▪The terms and conditions of appointment of non – executive directors should be made available for inspection.

▪Non – executive directors should undertake that they will have sufficient time to meet what is expected of them.

▪The board should not agree to a full time executive director taking on more than one non – executive directorship.

▪A separate section of the annual report should describe the work of the nomination committee, including the process it has used for Board appointments.

Information and professional development

▪The board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties.

▪All directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge.

▪The chairman is responsible for ensuring that the directors receive accurate, timely and clear information.

▪Management has an obligation to provide such information but directors should seek clarification or amplification where necessary.

Company Secretary

▪Under the direction of the chairman, the company secretary's responsibilities include

i) ensuring good information flows within the board

ii) its committees and between senior management and non – executive directors,

iii) facilitating induction and assisting with professional development as required.

▪Should be responsible for advising the Board through the Chairman on all governance matters.

▪All directors should have access to the advice and services of the company secretary, who is responsible to the board for ensuring that board procedures are complied with.

▪Both the appointment and removal of the company secretary should be a matter for the board as a whole.

▪The chairman should ensure that new directors receive a full, formal and tailored induction on joining the board.

▪As part of this, the company should offer to major shareholders the opportunity to meet a new non – executive director.

Performance Evaluation

▪The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.

▪Individual evaluation should aim to show whether each director continues to contribute effectively and discharge their responsibilities.

▪The chairman should act on the results of the performance evaluation by recognizing the strengths and addressing the weaknesses of the board.

▪Where appropriate, the Board should propose new members in replacement or seek the resignation of directors.

▪The board should state in the annual report how performance evaluation of the board, its committees and its individual directors has been conducted.

▪The non – executives directors, led by the senior independent director, should be responsible for performance evaluation of the chairman, taking into account the views of executive directors.

Re – election

▪All directors should be submitted for re – election at regular intervals, subject to continued satisfactory performance.

▪The board should ensure planned and progressive refreshing of the board.

How it should be done:

▪All directors should be subject to election by shareholders at the first annual general meeting after their appointment, and to re – election thereafter at intervals of no more than three years.

▪Non – executive directors should be appointed for specified terms subject to re – election and to Companies Acts provisions relating to the removal of a director.

▪The board should set out to shareholders in the papers accompanying a resolution to elect a non – executive director why they believe an individual should be elected.

Remuneration

The Level and Make – Up of Remuneration

▪Levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the company successfully

▪But a company should avoid paying more than is necessary for this purpose.

▪A significant proportion of executive directors' remuneration should be structured so as to link rewards to corporate and Individual performance.

Remuneration for Executive Directors

▪The performance – related elements of remuneration should forma significant proportion of the total remuneration package of executive directors

▪It should be designed to align their interests with those of shareholders

▪Give these directors keen incentives to perform at the highest levels.

▪Executive share options should not be offered at a discount save as permitted by the relevant provisions of the Listing Rules.

Remuneration of Non-Executive Directors

▪Levels of remuneration for non – executive directors should reflect the time commitment and responsibilities of their role.

▪Remuneration for non – executive directors should not include share options.

Remuneration Committee

▪There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors.

▪No director should be involved in deciding his or her own remuneration.

▪The board should establish a remuneration committee of at least three, or in the case of smaller companies two, members, who should all be independent non – executive directors.

▪The remuneration committee should have delegated responsibility for setting remuneration for all executive directors and the chairman, including pension rights and any compensation payments.

▪The board itself or, where required by the Articles of Association, the shareholders should determine the remuneration of non – executive directors within the limits set in the Articles of Association.

▪Shareholders should be invited specifically to approve all new long – term incentive schemes and significant changes thereto.

ACCOUNTABILITY AND AUDIT

Financial Reporting

▪The board should present a balanced and understandable assessment of the company's position and prospects.

▪This should include interim and other price – sensitive public reports and reports to regulators as well as to information required to be presented by statutory requirements.

▪The Directors should explain in the annual report their responsibility for preparing the accounts and there should be a statement by the auditors about their reporting responsibilities.

▪The directors should report that the business is a going concern, with supporting assumptions or qualifications as necessary.

Internal Control

▪The board should maintain a sound system of internal control to safeguard shareholders' investment and the company's assets.

▪The board should, at least annually, conduct a review of the effectiveness of the group's system of internal controls and should report to shareholders:

i) That they have done so.

ii) That it covers all material controls,

iii) Financial and operational controls

iv) compliance controls a

v) risk management systems.

Audit Committee and Auditors

- The board should establish formal and transparent arrangements which should apply to financial reporting and internal control principles
- Also maintain appropriate relationship with the company's auditors.
- The board should establish an audit committee of at least three, or in the case of smaller companies two members, who should all be independent non – executive directors.
- The board should satisfy itself that at least one member of the audit committee has recent and relevant financial experience.
- ▪ The main role and responsibilities of the audit committee should be set out in writing which should include:
- to monitor the integrity of the financial statements of the company, and any formal announcements relating to the company's financial performance,
- to review the company's internal financial controls
- to review the company's internal control and risk management system
- to monitor and review the effectiveness of the company's internal audit function;

▪to make recommendations to the board, in relation to the appointment, re-appointment and removal of the external auditor and to approve the remuneration and terms of engagement of the external auditor;

▪to review and monitor the external auditor's independence and objectivity and the effectiveness of the audit process, taking into account Regulatory requirements;

▪to develop and implement policy on engagement of external auditor to supply non – audit services, taking into account relevant ethical guidance regarding the provision of non – audit services by the external audit firm;

▪to report to the board, identifying any matters in respect of which it considers that action or improvement is needed.

▪The audit committee should review arrangements by which staff of the company may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters.

▪The audit committee should monitor and review the effectiveness of the internal audit activities.

▪Where there is no internal audit function, the audit committee should consider annually whether there is a need for an internal audit function

▪The audit committee should have primary responsibility for making a recommendation on the appointment, reappointment and removal of the external auditors.

▪If the board does not accept the audit committee's recommendation for renewal of External Auditor, it should be included in the annual report, and Board should set out reasons why it has taken a different position.

▪The annual report should explain to shareholders how, if the auditor provides non – audit services, auditor's objectivity and independence is safeguarded.

Relations With Shareholders

▪There should be dialogue with shareholders based on the mutual understanding of objectives.

▪ The board has a responsibility for ensuring that a satisfactory dialogue with shareholders takes place.

▪The board should state in the annual report the steps they have taken to ensure that the members of the board, and in particular the non – executive directors, develop an understanding of the views of major shareholders.

Constructive Use of AGM

▪The board should use the AGM to communicate with investors and to encourage their participation.

▪The company should count all proxy votes and, except where a poll is called, should indicate the level of proxies lodged on each resolution, and notes for and against the resolution and the number of abstentions.

▪The company should ensure that votes cast are properly received and recorded.

▪The chairman should arrange for the chairmen of the audit, remuneration and nomination committees to be available to answer questions at the AGM and for all directors to attend.

▪The company should arrange for the Notice of AGM and related papers to be sent to shareholders at least 20 working days before the meeting.

SARBANES OXLEY ACT, 2002 USA

<u>Background</u>

- **Revelations of fraud and major reporting scandals**
- **Investment community concern – significant declines in stock market**
- **Overwhelming pressure on political leaders to act**
- **July 2002 – Sarbanes-Oxley Act**
- **Dynamic period of reform in corporate America**

Salient futures of Sarbanes-Oxley Act

▪On July 30, 2002 President Bush signed into law the Sarbanes-Oxley Act of 2002.

▪The law is intended to bolster public confidence in the capital markets and impose new duties and significant penalties for non compliance on public companies and their executives, directors, auditors, attorneys and securities analysts.

▪The full implications of the legislation will be known after further actions by the Securities and Exchange Commission and the newly created Public Company Accounting Oversight Board.

▪Most of the provisions of this new law only apply to public companies that file a form 10-K with the Securities and Exchange Commission their auditors and securities analyists.

Title I: Public Company Accounting Oversight Board

▪Establishes a five member Public Company Accounting Oversight Board (with general oversight by the SEC) to:

oOversee the audit of public companies

oEstablish audit report standards and rules

▪Inspect, investigate and enforce compliance on the part of registered public accounting firms and those associated with the firms.

▪Requires public accounting firms that participate in any audit report with respect to any issuer to register with the Board (includes foreign public accounting firms that prepare an audit report for an issuer)

▪Directs the Board to establish (or modify) the auditing and related attestation standards, quality control and the ethics standards used by registered public accounting firms to prepare and issue audit reports.

Requires auditing standards to include (among other things):

- Seven year retention period for audit work papers
- Second partner review and approval
- Evaluation of whether internal control structure and procedures include records that accurately reflect transactions and disposition of assets.
- Receipts and expenditures are made only with authorization of senior management and directors
- Description of both material weaknesses in internal controls and of material noncompliance

Mandates continuing inspections of public accounting firms for compliance:

- annually for firms that provide audit reports for more then 100 issuers
- at least every three years for firms that provide audit reports for 100 or fewer issuers
- Empowers the Board to impose disciplinary or remedial sanctions upon registered firms and their associates for intentional conduct or repeated instances of negligent conduct.
- Directs the SEC to report to Congress on adoption of a principles-based accounting system by the U.S. financial reporting system.
- Funds the Board through fees collected from issuers.

Title II: Auditor Independence

▪Prohibits an auditor from performing specified non-audit services contemporaneously with an audit.

▪Allows the audit committee to approve some activities for non-audit services that are not expressly forbidden by the Act.

▪Prohibits an audit partner from being the lead or reviewing auditor for more then five consecutive years (auditor rotation).

▪Requires that auditors report to the audit committee:

- Critical accounting policies and practices used in the audit
- Alternative treatments and their ramifications within GAAP

- Material written communications between the auditor and senior management of the issuer.
- Places a one year prohibition on auditor performing audit services if the issuer's senior executives had been employed by that auditor and had participated in the audit of the issuer during the one year period preceding the audit initiation date.
- Encourages State regulatory authorities to make independent determinations on the standards for supervising non-registered public accounting firms and consider the size and nature of their clients' businesses audit.

Title III: Corporate Responsibility

- Requires each member of the audit committee to be a member of the board of directors, but otherwise independent (no other compensatory fees or affiliations with the issuer).
- Confers upon the audit committee responsibility for appointment, compensation and oversight of any registered public accounting firm employed to perform audit services.
- Gives audit committee authority to hire independent counsel and other advisors and requires issuer to fund them.
- Instructs the SEC to promulgate rules requiring the CEO and CFO to certify in periodic financial reports:

- The report does not contain untrue statements or material omissions

- The financial statements fairly present, in all material respects the financial conditions and results of operations
- Such officers are responsible for internal controls designed to ensure that they receive material information regarding the issuer and consolidated subsidiaries
- That the internal controls have been reviewed for their effectiveness within 90 days prior to the report.

▪Any significant changes to the internal controls

▪Re-incorporation or transfer of corporate domicile or offices from inside the US does not impact the reach of the rules in the filing of these reports

▪Deems it to be unlawful for corporate personnel to exert improper influence upon an audit for the purpose of rendering financial statements materially misleading

▪The CEO and CFO must forfeit certain bonuses and compensation received if the company is required to make an accounting restatement due to the material non compliance of an issuer. (bonuses and compensation one year from the original issuance or filing that needed restating)

▪Amends the Securities and Exchange Act of 1933 to authorize a violator of certain SEC rules from serving as an officer or director if the person's conduct demonstrates unfitness to serve…the previous rule required "substantial unfitness".

▪Provides a ban on trading by directors and executive officers in a public company's stock during pension fund blackout periods

▪Imposes obligations on attorneys appearing before the SEC to report violations of securities laws and breaches of fiduciary duty by a public company or its agents to the chief legal counsel or CEO of the company.

▪Allows civil penalties to be added to a disgorgement fund for the benefit of victims of securities violations.

Title IV: Enhanced Financial Disclosures

- Requires financial reports filed with the SEC to reflect all material correcting adjustments that have been identified. Requires disclosure of all material off-balance sheet transactions and relationships that may have a material effect upon the financial status of an issue.
- Prohibits personal loans extended by a corporation to its executives and directors with some exceptions including loans made by an insured depository institution if they are subject to the insider lending restrictions of the Federal Reserve Act (Reg. O).
- Requires senior management, directors, and principal stockholders to disclose changes in securities ownership or securities based swap agreements within two business days (formerly ten days after the close of the calendar month). Mandates electronic filing and availability of such disclosures one year after the date of enactment.
- Annual reports are to include an internal control report which states that the management is responsible for the internal control structure and procedures for financial reporting and assesses the effectiveness of the internal controls for the previous fiscal year.
- Requires issuer to disclose whether it has adopted a code of ethics for its senior financial officers and whether its audit committee consists of at least one member who is a financial expert.
- Mandates regular, systematic SEC review of periodic disclosures by issuers, including review of an issuer's financial statement.

Title V: Analyst Conflicts of Interest

▪Restricts the ability of investment bankers to pre-approve research reports

▪Ensures research analysts are not supervised by persons involved in investment banking activities

▪Prevents retaliation against analysts by employers in return for writing negative reports

▪Establishes blackout periods for brokers or dealers participating in a public offering during which they may not distribute reports related to such offering

▪Enhances structural separation in registered brokers or dealers between analyst and investment banking activities

▪Requires specific conflict of interest disclosures by research analysts making public appearances and by brokers or dealers in research reports including:

- ❖ Whether the analyst holds securities in the public company that is the subject of the appearance or report
- ❖ Whether any compensation was received by the analyst, or broker or dealer, from the company that was the subject of the appearance or report
- ❖ Whether a public company that is the subject of an appearance or report is, or during the prior one year period was, a client of the broker or dealer
- ❖ Whether the analyst received compensation with respect to a research report, based upon banking revenues of the registered broker or dealer.

Title VI: Commission Resources and Authority

▪Authorizes a 77.21% increase over the appropriations for FY 2002 including money for pay parity, information and technology, security enhancements, and recovery and mitigation activities related to the September 11th terrorist attacks.

▪$98 million is included to hire no less then 200 additional qualified professionals to provide improved oversight of auditors and audit services.

▪Authorizes the SEC to censure persons appearing or practicing before the Commission if it finds, among other things, a person to have engaged in unethical or improper professional conduct.

▪Authorizes Federal courts to prohibit persons from participating in penny stock offerings if the persons are subject proceedings instituted for alleged violations of securities laws.

▪Expands the scope of the SEC's disciplinary authority by allowing it to consider orders of state securities commissions when deciding whether to limit the activities, functions, or operations of brokers or dealers.

Title VII: Studies and Reports

❖ **Sets up various reports and studies including:**

- Factors leading to the consolidation of public accounting firms and its impact on capital formation and securities markets
- The role of credit rating agencies in the securities markets
- The number of securities professionals practicing before the Commission who have aided an abetted Federal securities violations but have not been penalized as a primary violator
- SEC enforcement actions it has taken regarding violations of reporting requirements and restatements of financial statements.
- Report on whether investment banks and financial advisors assisted public companies in earnings, manipulation and obfuscation of financial conditions.

Title VIII: Corporate and Criminal Fraud Accountability

☞ **Imposes criminal penalties:**

i) knowingly destroying, altering, concealing, or falsifying records with intent to obstruct or influence either a Federal investigation or a matter in bankruptcy

ii) for failure of an auditor to maintain for a five year period all audit or review work papers pertaining to an issuer of securities

iii) ten years in prison punishment

☞ Makes non-dischargeable in bankruptcy certain debts incurred in violation of securities fraud laws.

☞ Extends the statute of limitations to permit a private right of action for a securities fraud violation to not later then two years after its discovery or five years after the date of the violation

☞ Provides whistleblower protection to prohibit a publicly traded company from retaliating against an employee because of any lawful act by the employee to assist in an investigation of fraud or other conduct by Federal regulators, Congress or supervisors, or to file or participate in a proceeding relating to fraud against shareholders.

☞ Subjects to fine or imprisonment (up to 25 years) any person who knowingly defrauds shareholders of publicly traded companies

☞

Title IX: White Collar Crime Penalty Enhancements

▪Increases penalties for mail and wire fraud from five to twenty years in prison

▪Increases penalties for violations of the Employee Retirement Income Security Act of 1974 (up to $500,000 and 10 years in prison)

▪Establishes criminal liability for failure of corporate officers to certify financial reports, including maximum imprisonment of ten years for knowing that the periodic report does not comply with the act or for twenty years for willfully certifying a statement knowing it does not comply with this Act.

Title X: Corporate Tax Returns

- Expresses the sense of the Senate that the Federal income tax return of a corporation should be signed by its chief executive officer

Title XI: Corporate Fraud Accountability

- Amends Federal criminal law to establish a maximum 20 year prison term for tampering with a record or otherwise impeding an official proceeding
- Authorizes the SEC to seek a temporary injunction to freeze extraordinary payments earmarked for designated persons or corporate staff under investigation for possible violations of Federal securities law.
- Authorizes the SEC to prohibit a violator of rules governing manipulative, deceptive devices, and fraudulent interstate transactions, from serving as officer or director of a publicly traded corporation if the persons conduct demonstrates unfitness to serve.
- Increases penalties for violations of the Securities Exchange Act of 1934 to up to $25 million dollars and up to 20 years in prison.

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