

GOVERNANCE, BUSINESS ETHICS AND SUSTAINABILITY

Time allowed : 3 hours

Maximum marks : 100

PART A

*(Answer Question No. 1 which is compulsory
and any two of the rest from this part)*

Question 1

- (a) *"The controlled mis-governance is a type of fraud that is perpetrated by the person(s) running the company. In such situations, the management deceptively leads all the stakeholders to believe that the company is being run superbly successfully, while in reality it is led to bankruptcy." With reference to the statement, examine the issues and challenges in Corporate Governance citing relevant case(s) of corporate scams. (10 marks)*
- (b) *State, with reasons in brief, whether the following statements are true or false :*
- (i) *Insurance is a method of risk avoidance.*
 - (ii) *Insider may not simply steal the earnings.*
 - (iii) *Remuneration committee is constituted to determine the remuneration of CEO only.*
 - (iv) *In terms of Clause 49 of the listing agreement, 'related party transactions' are prohibited.*
 - (v) *Internal control plays an important role in preventing and detecting fraud and protecting the organisation's resources. (2 marks each)*

Answer 1(a)

Controlled misgovernance is a type of fraud that is perpetrated by the person(s) running the company. In such a situation the management deceives all the stakeholders into believing that they run a superbly successful business but in reality it is heading towards bankruptcy. It then becomes impossible for us to believe that the governance of firm could have duped all its stakeholders.

But that is how controlled misgovernance is expected to unfold in the days to come. The grossly inflated numbers in the financial statements are backed by documentation that makes outside auditors to rely on them which in turn provide the cover of apparent neutrality for the perpetrators of the fraud. So, in such a scenario the regulators and independent directors instead of defending the interests of the investors end up advocating the interest of the management. When the fraud unfolds auditors often seek reduced liability.

The Satyam case misgovernance highlighted the lack of independent director's interest in the Board processes, they did not play their role in efficient manner and the consequences proceeded. The mere meeting of criteria of independence does not ensure that an independent director is acting independently. They should play a vigilant role by

attending the meetings, studying and analysing the agenda papers, ask the right questions at the right time, insist that dissent if any is recorded, and have separate sessions of independent directors and act with integrity.

On the other hand the auditors in this case have tried to distance themselves from the fraud perpetrated by the management by issuing a statement that “The representations made by the Chairman and other management to the auditors during the audit now appear to be false and, therefore, are no longer reliable.”

Some issues and challenges that need scrutiny are:

(i) *Role of Independent directors*

Independent directors are known to bring an objective view in board deliberations. They are required to ensure that there is no dominance of one individual or special interest group or the stifling of healthy debate. They should act as the guardians of the interest of all shareholders and stakeholders, especially in the areas of potential conflict. Independent Directors bring a valuable outside perspective to the deliberations.

(ii) *Role of independent directors in audit committee*

Independent directors' play a crucial role in Audit Committee. The audit committee is responsible to ensure the integrity of financial reporting, therefore, each independent director who is a member of audit committee should be able to read and understand financial statements.

(iii) *Tenure of independent directors*

Excessively long tenure of independent directors may compromise their independence. On being associated for a long period with a company, there is a strong likelihood that independent directors lose their objectivity. Clause 49 does specify as a non-mandatory requirement that the maximum term should not exceed nine years.

(iv) *Flow of information to the board*

Companies should ensure that timely, relevant and complete information is made available to independent directors so that they are able to make informed decisions. The independent directors on their part should also question and seek clarifications whenever in doubt.

(v) *Recording of dissent*

It is important that where an independent director is not in agreement with the decision of the majority, he should insist that his dissent be recorded.

(vi) *Role of Auditor*

Auditors are expected to work with and not against management, while always remaining professionally objective - that is to say, applying their professional skills impartially and retaining a critical detachment and a consciousness of their accountability to those who formally appoint them. Maintaining such a professional and objective relationship is the responsibility both of boards of

directors and of auditors, as is that of taking appropriate action if the basis for that relationship no longer holds.

Audits are a reassurance to all who have a financial interest in companies, quite apart from their value to boards of directors. The role of the auditors is not just to go by the numbers presented in the accounts and sign off bogus accounts rather they need to verify the facts presented by the company.

Even if there is a remotest possibility that this may indeed be the case then it must show the way forward for auditors to directly interact with the banks and other institutions to obtain the required confirmation and for the independent directors to play a major role in effective oversight body to hold the management accountable to the shareholders.

Answer 1(b)(i)

False

It is not a method of risk avoidance rather it is risk transfer. The value of the insurance lies in the financial security that a firm can obtain by transferring to an insurer, in return for a premium for the risk of losses that might arise on the occurrence of a specified peril. Insurance does not protect a firm against all perils but it offers restoration, at least in part of any resultant economic loss.

Answer 1(b)(ii)

True

The Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992, define that "Insider" is any person, who is or was connected with the company, and who is reasonably expected to have access to unpublished price-sensitive information about the stock of that particular company, or who has access to such unpublished price sensitive information.

Answer 1(b)(iii)

False

Remuneration Committee or Compensation Committee is constituted by a company to determine the remuneration packages of directors including chief executive officers.

Answer 1(b)(iv)

False

Clause 49 do not prohibit 'related party transactions' rather it provides for review of related party transaction by Audit Committee and its disclosure.

Answer 1(b)(v)

True

The system of internal control facilitates the effectiveness and efficiency of operations, helps ensure the reliability of internal and external reporting and assists in compliance with laws and regulations. They help to ensure that a company is not

unnecessarily exposed to avoidable financial risks and that the financial information used within the business and for publication is reliable. They also contribute to the safeguarding of assets, including the prevention and detection of frauds.

Question 2

(a) Write short notes on any three of the following :

- (i) CEO/CFO certification
 - (ii) Relationship between directors and managers
 - (iii) Task force on corporate excellence through governance
 - (iv) Corporate philanthropy and corporate social responsibility (CSR).
- (3 marks each)

(b) Describe the tools used by the institutional investors to assess the health of a company before investing resources in it. (6 marks)

Answer 2(a)(i)

Clause 49 of the Listing Agreement requires that the CEO, i.e., the Managing Director or Manager appointed in terms of the Companies Act, 1956 and the CFO i.e. the whole-time Finance Director or any other person heading the finance function discharging that function shall certify to the Board that to the best of their knowledge:

- (a) the financial statements and the cash flow statement reviewed by them do not contain any materially untrue statement or omit any material fact or contain statements that might be misleading and that they present a true and fair view of the company's affairs and are in compliance with existing accounting standards, applicable laws and regulations.
- (b) no transactions entered into by the company during the year are fraudulent, illegal or violative of the company's code of conduct.
- (c) They have indicated to the auditors and the Audit Committee of any significant changes in internal control, accounting policies over financial reporting during the year or any instances of significant fraud of which they have become aware and the involvement therein;

Answer 2(a)(ii)

Directors and managers need to work together based on mutual respect, trust and commitment. A board provides counsel to management and should not get involved in the day-to-day affairs of the organization. Clear expectations for the board and the director need to be established and maintained, because a board that is overly active in management can inhibit the organization's effectiveness. The Executive Management can help the board govern more and manage less by adopting the following three methods:

- Use a comprehensive strategic plan that has been developed in conjunction with the board, and supplement it with regular progress reports. This will keep the board's sights focused on the long term goals and mission of the organization. Regular reports will keep board members apprised of progress toward organizational goals, and provide part of the basis for evaluation of the executive management.

- Provide the board with relevant materials before board meetings, and explain why the materials are coming to the attention of the board. Let board members know how specific agenda items relate to the organization's larger mission, and what kind of action or discussion is desired of the board on each item.
- Facilitate board and board committee discussions so that the board stays focused on the larger issues. Refer to set policies that define the limits of the board's decision-making power, and strive to engage the board in a dialogue among themselves that leads to consensus-building.

Answer 2(a)(iii)

In November 2000, a Task Force on Corporate Excellence set up by the group under the chairmanship of Dr. P.L. Sanjeev Reddy, Secretary, DCA (now MCA) produced a report containing a range of recommendations for raising governance standards among all companies in India. The group examined ways to “operationalise the concept of corporate excellence on a sustained basis”, so as to “sharpen India’s global competitive edge and to further develop corporate culture in the country”.

A Summary of Report of Task Force:

1. Higher delineation of independence criteria and minimization of interest-conflict potential.
2. Directorial commitment and accountability through fewer and more focussed board and committee membership.
3. Meaningful and transparent accounting and reporting, improved annual report along with more detailed filing with regulatory authorities.
4. Setting up of an independent, Autonomous Centre for Corporate Excellence to accord accreditation and promote policy research and studies, training and education, etc., in the field of corporate excellence through improved corporate governance.
5. Introducing formal recognition of Corporate Social Responsibility.
6. Clear distinction between two basic components of governance in terms of policy making and oversight responsibilities of the board of directors.
7. Apply the highest and toughest standards of corporate governance to Listed companies.
8. PSUs be relieved from multiple surveillance agencies and simultaneously a commission be appointed to draft a suitable code of public behaviour.

Answer 2(a)(iv)

Difference between CSR and Philanthropy/Charity

Corporate Social Responsibility is about how a company aligns their values to social causes by including and collaborating with their investors, suppliers, employees, regulators and the society as a whole. The investment in CSR may be on people centric issues and/ or planet issues. CSR initiatives of a corporate is not a selfless act of giving;

companies derive long-term benefits from the CSR initiatives and it is this enlightened self interest which is driving the CSR initiatives in companies.

On the other hand, philanthropy means the act of donating money, goods, time or effort to support a charitable cause with regard to a defined objective. Philanthropy can be equated with benevolence and charity for the poor and needy. Philanthropy can be any selfless giving towards any kind of social need that is not served, underserved, or perceived as unserved or underserved. Philanthropy can be by an individual or by a corporate.

The Etymological origin of the word is from Late Latin *philanthropia*, from Greek *philanthropia*, from *philanthropos* loving people that is *phil-* + *anthropos* human being. It is the active effort to promote human welfare.

Answer 2(b)

Institutional investors remain alert while investing in a company; they assess the health of company before investing resources in it. Following are the tools used by Institutional Investors

(i) *One-to-one meetings*

The meetings between institutional investors and companies are extremely important as a means of communication between the two parties.

(ii) *Voting*

The right to vote which is attached to voting shares is a basic prerogative of share ownership, and is particularly important given the division of ownership (shareholders) and control (directors) in the modern corporation. The right to vote can be seen as fundamental tools for some element of control by shareholders. The institutional investors can register their views by postal voting, or, vote electronically where this facility is available.

(iii) *Focus lists*

A number of institutional investors have established 'focus lists' whereby they target underperforming companies and include them on a list of companies which have underperformed a main index, such as Standard and Poor's. After being put on the focus list, the companies often receive unwanted attention of the institutional investors who may seek to change various directors on the board.

(iv) *Corporate governance rating systems*

A number of corporate governance rating systems come up with the development of corporate governance. Examples of such firms which have developed corporate governance rating systems are Deminor, Standard and Poor's, and Governance Metrics International (GMI). The ratings will also be useful to governments in identifying perceived levels of corporate governance in their country compared to other countries in their region, or outside it, whose companies may be competing for limited foreign investment. A corporate governance rating could be a powerful indicator of the extent to which a company currently is adding, or has the potential

to add in the future, shareholder value. This is because a company with good corporate governance is generally perceived as more attractive to investors than one without.

Question 3

- (a) *“The Global Corporate Governance Forum’s mandate is to promote global, regional and local initiatives that improve Corporate Governance policy standards and practices in developing countries.” Elucidate this statement. (5 marks)*
- (b) *“To enable better and more focused attention on the affairs of the company, the Board delegates particular matters to committees of the Board set-up for the purpose but the ultimate responsibility lies with the Board.” In the light of the statement, discuss the need and advantages of committee management. (5 marks)*
- (c) *What is ‘risk retention’ ? Distinguish between ‘risk retention’ and ‘risk transfer’. (5 marks)*

Answer 3(a)

The Global Corporate Governance Forum (the Forum) was founded in 2001 by the World Bank and the Organisation for Economic Co-operation and Development (OECD) following the financial crises in Asia and Russia in the latter part of the 1990's. It was established to promote initiatives to raise corporate governance standards and practices in developing countries and emerging markets, using the OECD Principles of Corporate Governance as the basis for its work.

The Forum's mandate is to promote global, regional and local initiatives that improve corporate governance policy standards and practices in developing countries. The Forum focuses on the following four areas:

- (a) raising awareness and building consensus for implementation of reform through meetings, briefings, policy papers, and conferences;
- (b) sponsoring research relevant to the needs of developing countries to underpin reform efforts by sound analysis through sponsoring papers and building sustainable networks for academics in developing countries;
- (c) disseminating best practice materials and publications and guidelines developed with leading global specialists and practitioners; and
- (d) supporting institution and capacity building and providing technical assistance to ensure implementation at the field level through training programs, toolkits and other direct assistance.

Answer 3(b)

With the globalization the regulatory requirements have become more complex and the onus on the board is immense. In this scenario the need to delegate oversight to a board committee has become imperative.

To enable better and more focused attention on the affairs of the company, the board delegates particular matters to committees of the board set up for the purpose however the ultimate responsibility lies with the board.

Advantages of Board Committee Management

Committees allows the board to

- Handle a greater number of issues with greater efficiency by having experts focus on specific areas.
- Develop subject specific expertise on areas such as compliance management, risk management, financial reporting.
- Enhance the objectivity and independence of the board's judgment.

Greater specialization and intricacies of modern board work is one of the reasons for increased use of board committees. The reasons include:

- Responsibilities are shared.
- More members become involved.
- Specialized skills of members can be used to best advantage.
- Inexperienced members gain confidence while serving on the committee.
- Matters may be examined in more detail by a committee

The committees focus accountability to known groups. While the board as a legal unit always retains responsibility for the work of its Committees, the committee because of its focus on the mandate, the size of the committee being relatively smaller than the Board tend to be more effective.

Answer 3(c)**Risk Retention**

It is also known as risk assumption or risk absorption. It is the most common risk management technique. This technique is used to take care of losses ranging from minor to major break-down of operation. There are two types of retention methods for containing losses as under:

- (i) Risk retained as part of deliberate management strategy after conscious evaluation of possible losses and causes. This is known as active form of risk retention.
- (ii) Risk retention occurred through negligence. This is known as passive form of risk retention.

Risk Transfer

This refers to legal assignment of cost of certain potential losses to another. The insurance of 'risks' is to occupy an important place, as it deals with those risks that could be transferred to an organization that specialises in accepting them, at a price. Usually, there are 3 major means of loss transfer viz., (i) By Tort (ii) By contract other than insurance (iii) By contract of insurance. The main method of risk transfer is insurance. The value of the insurance lies in the financial security that a firm can obtain by transferring to an insurer, in return for a premium for the risk of losses arising from the occurrence of a specified peril. Thus, insurance substitutes certainty for uncertainty. Insurance does

not protect a firm against all perils but it offers restoration, atleast in part of any resultant economic loss.

Question 4

- (a) *Elaborate the provisions in respect of the composition of audit committee under the following :*
- (i) *Listing agreement as prescribed by SEBI.*
 - (ii) *NYSE listing rules.*
 - (iii) *Section 292A of the Companies Act, 1956.* (3 marks each)
- (b) *Discuss the background stating some case laws, which brought about the development of insider trading law.* (6 marks)

Answer 4(a)(i)

Composition of Audit Committee under Listing Agreement

A qualified and independent audit committee shall be set up, giving the terms of reference subject to the following:

1. The audit committee shall have minimum three directors as members. Two-thirds of the members of audit committee shall be independent directors.
2. All members of audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise.

Explanation 1 : 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 2 : 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.

3. The Chairman of the Audit Committee shall be an independent director;
4. The audit committee may 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 a representative of the statutory auditor may be present as invitees for the meetings of the audit committee;
5. The Company Secretary shall act as the secretary to the committee.

Answer 4(a)(ii)

Composition of Audit Committee under NYSE Rules

- The audit committee must have a minimum of three members.
- All the members of the Audit Committee must be independent

- Each member of the audit committee must be financially literate, as such qualification is interpreted by the company's board in its business judgment, or must become financially literate within a reasonable period of time after his or her appointment to the audit committee.
- In addition, at least one member of the audit committee must have accounting or related financial management expertise, as the company's board interprets such qualification in its business judgment.

Answer 4(a)(iii)

Section 292A of Companies Act 1956

The Committee shall consist of at least three directors and such number of other directors as the Board may determine. Two-thirds of the total number of members of the committee shall be directors other than managing or whole time directors. Members of the committee shall elect a chairman from amongst themselves. The Annual Report of the Company shall disclose the composition of the Audit Committee.

The auditors, the internal auditor, if any, and the director-in charge of finance shall attend and participate at meetings of the Audit Committee but shall not have the right to vote.

Answer 4(b)

Much of the development of insider trading law has resulted from court decisions.

In *SEC v. Texas Gulf Sulphur Co.* (1966) (U.S.A), a federal circuit court stated that anyone in possession of inside information must either disclose the information or refrain from trading.

In *United States v. Carpenter* (1986) the U.S. Supreme Court cited an earlier ruling while unanimously upholding mail and wire fraud convictions for a defendant who received his information from a journalist rather than from the company itself. The journalist R. Foster Winans was also convicted, on the grounds that he had misappropriated information belonging to his employer, the Wall Street Journal. In that widely publicized case, Winans traded in advance of "Heard on the Street" columns appearing in the Journal.

The court ruled in *Carpenter*: "It is well established, as a general proposition, that a person who acquires special knowledge or information by virtue of a confidential or fiduciary relationship with another is not free to exploit that knowledge or information for his own personal benefit but must account to his principle for any profits derived there from."

The misuse is subject to varying interpretations. The insider-trading allegation against Hindustan Lever (HLL) for purchasing eight lakh shares of Brooke Bond Lipton India (BBLIL) from Unit Trust of India a month before the merger of the two companies was announced is a case in point.

HLL appealed against SEBI's order to the Appellate Authority of the Finance Ministry claiming that a company cannot be an insider to itself and that the shares were bought solely with the intent of preserving the parent company, Unilever's 51 per cent stake in HLL. It was further argued that the reports on the HLL and BBLIL merger had already

been published by various entities. So it was not acting on undisclosed or unpublished information.

SEBI the Market regulator has put in place a comprehensive Integrated Market Surveillance System to track trading data from all the market participants stock exchanges, depository participants, custodians as well as data of clearing houses.

PART B

(Answer ANY TWO questions from this part)

Question 5

- (a) *Most of the companies begin the process of establishing organisational ethics programme by developing codes of conduct. What are the core values or principles contained in these codes of conduct ? Briefly discuss the legal provisions in respect of codes of conduct in India and USA. (6 marks)*
- (b) *Write short notes on any three of the following :*
- (i) *Ethics in production*
 - (ii) *The Caux Round Table*
 - (iii) *Virtue ethics theory*
 - (iv) *Characteristics of ethical decisions. (3 marks each)*

Answer 5(a)

Codes of conduct are formal statements that describe what an organization expects of its employees. Such statements may take three different forms a code of ethics, a code of conduct, and a statement of values.

Corporate codes of ethics often contain about six core values or principles in addition to more detailed descriptions and examples of appropriate conduct. The six values that are desirable for codes of ethics include: (1) trustworthiness, (2) respect, (3) responsibility, (4) fairness, (5) caring, and (6) citizenship.

In India, Clause 49 of the Listing Agreement requires that

- (i) The Board shall lay down a code of conduct for all Board members and senior management of the company. The 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.

Explanation : For this purpose, the term “senior management” shall mean personnel of the company who are members of its core management team excluding Board of Directors. Normally, this would comprise all members of management one level below the executive directors, including all functional heads.

In the United States of America, Section 406 of the Sarbanes Oxley Act, 2002 requires public companies to disclose whether they have codes of ethics and also to disclose any waivers of those codes for certain members of senior management.

Section 406(a) of Regulation S-K requires companies to disclose:

- whether they have a written code of ethics that applies to their principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions;
- any waivers of the code of ethics for these individuals; and
- any changes to the code of ethics.

If companies do not have a code of ethics, they must explain why they have not adopted one. A company may either file its code as an exhibit to the annual report, post the code on the company's Web site or agree to provide a copy of the code upon request and without charge.

Answer 5(b)(i)

Ethics of Production

This area of business ethics deals with the duties of a company to ensure that products and production processes do not cause harm. Some of the more acute dilemmas in this area arise out of the fact that there is usually a degree of danger in any product or production process and it is difficult to define a degree of permissibility, or the degree of permissibility may depend on the changing state of preventative technologies or changing social perceptions of acceptable risk.

- Defective, addictive and inherently dangerous products and
- Ethical relations between the company and the environment include pollution, environmental ethics, carbon emissions trading
- Ethical problems arising out of new technologies for eg. Genetically modified food
- Product testing ethics.

The most systematic approach to fostering ethical behavior is to build corporate cultures that link ethical standards and business practices.

Answer 5(b)(ii)

The Caux Round Table

The Caux Round Table (CRT) is based on the belief that the world business community should play an important role in improving economic and social conditions. As a statement of its aspirations, it developed a document that aims to express a world standard against which business behavior can be measured.

The CRT Principles for Business were formally launched in 1994, and presented at the United Nations World Summit on Social Development in 1995. The CRT Principles for Business articulate a comprehensive set of ethical norms for businesses operating internationally or across multiple cultures. The CRT Principles for Business emerged from a series of dialogues catalyzed by the Caux Round Table during the late 1980's and early 1990's. The Principles are comprehensive statement of responsible business practice formulated by business leaders for business leaders.

Answer 5(b)(iii)

Virtue Ethics theory is a branch of moral philosophy that emphasizes character, rather than rules or consequences, as the key element of ethical thinking. An example of this – when a person of good standing is found possessing a valuable article belonging to someone else it will be presumed that the article was loaned to him or kept with him for safe-keeping, whereas if it were in the possession of a person of doubtful or dubious character it would be presumed that he has stolen article.

Answer 5(b)(iv)

According to Sueanne, in her book *Ethical Dilemma, Characteristics and Theory* (2008) states characteristics of ethical decisions which are enumerated as under:

Most Ethical Decisions Have Mixed Outcomes – “It is commonly thought that ethical issues in management are largely antithetical, with directly opposed financial returns and social costs. The antithetical model for outcome evaluation presents ethical issues in sharp focus but it does not accurately portray the managerial dilemma. Social benefits and cost as well as financial revenues and expenses are associated with almost all of the alternative in ethical choices.”

Most Ethical Decisions Have Personal Implications – “Most ethical decisions have personal implications. It is commonly thought that ethical issues in management are largely impersonal, divorced from the lives and careers of the managers. Many people believe that *prima facie* ethical decisions in a given operation may reduce the profits of the company but not the executives’ salaries or their opportunities for promotion.”

Most Ethical Decisions Have Multiple Alternatives – “It is commonly thought that ethical issue in management are primarily dichotomous, a “yes” or a “no” choice, with no other alternatives.”

Most Ethical Decisions Have Extended Consequences – “The results of managerial decisions and actions do not stop with first-level consequences. Rather, they extend throughout society, and extension constitutes the essence of the ethical argument: the decisions of managers have an impact upon others, both within the organization and within the society. The impact is beyond their control; hence, they should be seriously considered when decisions are made by managers.”

Most Ethical Decisions Have Uncertain Consequences – “It is commonly thought that ethical issues in management are free of risk and doubt, with a known outcome for each alternative. A deterministic model-that is, one without probabilities-simplifies the process of analysis, but it does accurately describe the managerial dilemma. It is not clear what consequences would follow...”

Question 6

- (a) “Writing a code of conduct, supporting it at top levels and communicating it to employees is just a beginning. Companies should have an ethics committee comprising of independent non-executive directors.” Enumerate the statement and state the functions of ethics committee. (5 marks)
- (b) Discuss the ‘stakeholder concept’ stating the principles enunciated by Evans and Freeman. (5 marks)

- (c) *What are the challenges of business ethics ? What are the two control systems that can be embodied in an ethics programme ?* (5 marks)

Answer 6(a)

Codes of conduct need to be living documents that are encouraged and valued at the highest levels. Board members and senior executives have to set an example for the type of conduct they expect from others. Ethical lapses at the higher levels of management tend to be perceived as tacit permission to commit lapses at lower levels. Senior management needs to hold itself to the highest standards of conduct before it can demand similar integrity from those at lower levels.

Companies should have a committee of independent non-executive directors who are responsible for ensuring that systems are in place in the company to assure employee compliance with the Code of Ethics.

Functions of Ethics Committee

The oversight process of the Ethics Committee of an organization involves the following areas to be addressed by it:

Review of the definitions of standards and procedures

The Committee should review the organization's areas of operation, the activities that require a formal set of ethical standards and procedures.

Once the review is complete and any shortcomings have come to light, the ethics committee should assign the creation of revised guidelines to the appropriate personnel, including the design of a formal method for communicating standards and procedures to employees. This method should ensure that employees both understand and accept the ethics program.

The ethics committee can suggest behaviors to upper management that reinforce the organization's guidelines.

Facilitate Compliance

The ethics Committee has the responsibility for overall compliance. It is the responsible authority for ethics compliance within its area of jurisdiction. It should serve as the court of last resort concerning interpretations of the organization's standards and procedures. When and if inconsistencies come to light in this manner, the committee should make recommendations on improving the existing compliance mechanisms. And, as always, there should be follow-up to ensure that compliance recommendations have been understood and accepted.

Due diligence of prospective employees

The ethics committee should define how the organization will balance the rights of individual applicants and employees against the organization's need to avoid risks that come from placing known violators in positions of discretionary responsibility. This includes the oversight of background investigations on employees/applicants who are being considered for such positions.

Oversight of communication and training of ethics programme

The ethics committee should define methods and mechanisms for communicating ethical standards and procedures. This includes the distribution of documents (codes of

conduct, for example) to ensure that every employee understands and accepts the organization's ethical guidelines. To make certain that published standards are understood, the ethics committee should provide regular training sessions as well.

Since communication is two-way, the ethics committee should solicit stakeholder input regarding how standards and procedures are defined and enforced. In this connection, it is useful to create ways of providing proof that each employee has received the appropriate documents and understands the standards and procedures described.

Monitor and audit compliance

Compliance is an ongoing necessity and the ethics committee should design controls which monitor, audit and demonstrate employees' adherence to published standards and procedures. There should also be mechanisms which check the effectiveness and reliability of such internal controls.

To warrant that the organization's goals, objectives and plans do not conflict with its ethical standards and procedures, the ethics committee should develop methods for regular review and assessment.

Enforcement of disciplinary mechanism

Disciplinary provisions should be in place to ensure consistent responses to similar violations of standards and procedures (as against applying different standards to different employees based on their position, performance, function, and the like). There should be provisions for those who ignore as well as those who violate standards and procedures.

Analysis and follow-up

When violations occur, the ethics committee should have ways to identify why they occurred. It is also important that lessons learned from prior violations are systematically applied to reduce the chance that similar violations takes place in future.

Answer 6(b)

In a business context, customers, investors and shareholders, employees, suppliers, government agencies, communities, and many others who have a "stake" or claim in some aspect of a company's products, operations, markets, industry, and outcomes are known as stakeholders. These groups are influenced by business, but they also have the ability to affect businesses.

Freeman defined stakeholder as 'any group or individual who can affect or is affected by the achievement of the organization's objectives'. This concept was elaborated by Evans & Freeman as the following two principles:

1. *Principles of corporate legitimacy*

The corporation should be managed for the benefit of its stakeholders: its customers, suppliers owners, employees & local communities. The rights of these groups must participate, in some sense, in decisions that substantially affect their welfare.

2. *The stakeholder fiduciary principle*

Management bears a fiduciary relationship to stakeholders and to the corporation

as an abstract entity. It must act in the interest of the stakeholders as their agent, and it must act in the interests of the corporation to ensure the survival of the firm, safeguarding the long-term stakes of each group.

Subsequently Freeman redefined stakeholder as "Those groups who are vital to the survival & success of the corporation" and the principles were altered renamed:

1. *The stakeholder enabling Principle* - Corporations shall be managed in the interest of stakeholders.
2. *The Principle of Director Responsibility* - Directors of a corporation shall have a duty of care to use reasonable judgment to define and direct the affairs of the corporation in accordance with the stakeholder enabling principle.

Answer 6(c)

Organizations have ethics programme as a way of minimizing the risk of ethical misconduct or wrongdoing by employees. These programmes consist of policies, processes and education and training initiatives that explain the company's business ethics. These programmes clarify how ethics should translate into operating procedures and workplace behaviour. The focus of ethics programmes is compliance and is focused on rules and regulations.

A company must have an effective ethics program to ensure that all employees understand its values and comply with the policies and codes of conduct that create its ethical climate.

Two types of control systems can be created.

Compliance Orientation Programme : A compliance orientation creates order by requiring that employees identify with and commit to specific required conduct. It uses legal terms, statutes, and contracts that teach employees the rules and penalties for noncompliance.

Values Orientation: *Values Orientation* strives to develop shared values. Although penalties are attached, the focus is more on an abstract core of ideals such as respect and responsibility. Instead of relying on coercion, the company's values are seen as something to which people willingly aspire.

Question 7

- (a) *"Dilemma is a situation that requires a choice between options that are seen equally unfavourable or mutually exclusive". In the light of this statement, elaborate the ethical dilemma. State the steps to resolve an ethical dilemma.*
(5 marks)
- (b) *Explain the concept of 'whistle blower'. How should a company evolve its whistle blower policy ?*
(5 marks)
- (c) *How do good business ethics practices help in attracting and retaining talent in the organisation and achieve customer satisfaction ?*
(5 marks)

Answer 7(a)

Dilemma is a situation that requires a choice between options that are or seem equally unfavorable or mutually exclusive.

An ethical dilemma involves a situation that makes a person question what is the 'right' or 'wrong' thing to do. Ethical dilemmas make individuals think about their obligations, duties or responsibilities. These dilemmas can be highly complex and difficult to resolve. Easier dilemmas involve a 'right' versus 'wrong' answer; whereas, complex ethical dilemmas involve a decision between right and right.

Steps to Resolving an Ethical Dilemma are as follows:

1. *What are the options ?*
List the alternative courses of action available.
2. *Consider the consequences*
Think carefully about the range of positive and negative consequences associated with each of the different paths of action available.
 - Who/what will be helped by what is done?
 - Who/what will be hurt?
 - What kinds of benefits and harms are involved and what are their relative values ?
 - What are the short-term and long-term implications?
3. *Analyse the actions*
Actions should be analysed in a different perspective i.e. viewing the action per se disregard the consequences, concentrating instead on the actions and looking for that option which seems problematic.
4. *Make decision and act with commitment*
Now, both parts of analysis should be brought together and a conscious and informed decision should be made. Once the decision is made, act on the decision assuming responsibility for it.
5. *Evaluate the system*
Think about the circumstances which led to the dilemma with the intention of identifying and removing the conditions that allowed it to arise.

Answer 7(b)

A **whistleblower** is a person who publicly complains concealed misconduct on the part of an organization or body of people, usually from within that same organisation. This misconduct may be classified in many ways; for example, a violation of a law, rule, regulation and/or a direct threat to public interest, such as fraud, health/safety violations, and corruption. Whistleblowers frequently are likely to face retaliation - sometimes at the hands of the organisation or group which they have accused unless a system is in place that would ensure confidentiality is maintained. It is in this context whistleblowers are often protected under law from employer retaliation.

In India, clause 49 of the Listing Agreement provides as under with regard to Whistle Blower Policy:

Whistle Blower Policy

The company may establish a mechanism for employees to report to the

management, concerns about unethical behaviour, actual or suspected fraud or violation of the company's code of conduct or ethics policy. This mechanism could also provide for adequate safeguards against victimization of employees who avail this and also provide direct access to the chairman of the Audit committee in exceptional cases. Once established, the existence of the mechanism may be appropriately communicated within the organization. This is a non-mandatory requirement. In case the whistle Blower mechanism is existing, the audit committee is responsible to review the functioning of the Whistle Blower mechanism.

Answer 7(c)

Retaining talent

People aspire to join organization with high ethical values. The ethical climate matter to the employees. Ethical organizations create an environment that is trustworthy, making employees willing to rely, take decisions and act on the decisions and actions of the co-employees. In such a work environment, employees can expect to be treated with respect and consideration by their colleagues and superiors. It cultivates strong teamwork and productivity and support employee growth.

Retaining talented people is as big a challenge as getting them in the first place. Work is a means to an end for them, not an end in itself. The relationship employees have with their employer must be a mutual, win-win one, in which their loyalty should not be taken for granted. Talented people will invest their energy and talent only in organizations with values and beliefs that match their own. In order to achieve this match, managers need to build cultures, compensation and benefits packages, and career paths that reflect and foster certain shared values and beliefs.

Customer satisfaction

Customer satisfaction is a vital factor in successful business strategy. Repeat purchases/orders and enduring relationship of mutual respect is essential for the success of the company. The name of a company should evoke trust and respect among customers for enduring success. This is achieved by a company that adopts ethical practices. When a company because of its belief in high ethics is perceived as such, any crisis or mishaps along the way is tolerated by the customers as a minor aberration. Such companies are also guided by their ethics to survive a critical situation. Preferred values are identified ensuring that organizational behaviors are aligned with those values. An organization with a strong ethical environment places its customers' interests as foremost. Ethical conduct towards customers builds a strong competitive position. It promotes a strong public image.

PART C

Question 8

Attempt any four of the following :

- (i) *Explain briefly the role of business in sustainable development in the light of UN Global Compact initiative.*
- (ii) *"The sustainability reporting guidelines developed by the Global Reporting Initiative (GRI), Netherlands, is a significant system that integrates sustainability*

issues into a framework of reporting.” Enumerate the steps to use the GRI reporting framework.

- (iii) State and enumerate corporate sustainability assessment criteria under the Dow-Jones Sustainability Index.*
- (iv) Write note on the ‘Convention on Biological Diversity’.*
- (v) Explain briefly the regulatory framework and the landmark case laws in respect of water pollution. (5 marks each)*

Answer 8(i)

The UN Global Compact is a policy framework for the development, implementation, and disclosure of sustainability principles and practices designed to establish sustainable business models and markets building inclusive global economy.

Trade and Industry being an integral part Human society has a pivotal role to play. In this direction, United Nations has initiated UN Global Compact, a strategic policy initiative for businesses that are committed to aligning their operations and strategies with ten universally accepted principles in the areas of human rights, labour, environment and anti-corruption. Through the process a business can ensure that markets, commerce, technology and finance advance in ways that benefit economies and societies everywhere.

The Global Compact is a voluntary corporate citizenship initiative with two objectives:

"Making the Global Compact and its principles part of business strategy and operations."

"Facilitating cooperation among key stakeholders and promoting partnerships in support of U.N. goals."

A company that signs-on to the Global Compact specifically commits itself to:

- set in motion changes to business operations so that the Global Compact and its principles become part of management, strategy, culture, and day-to-day operations;
- publish in its annual report or similar public corporate report (e.g. sustainability report) a description of the ways in which it is supporting the Global Compact and its principles (Communication on Progress),
- publicly advocate the Global Compact and its principles via communications vehicles such as press releases, speeches, etc.

Answer 8(ii)

A sustainability report should provide a balanced and reasonable representation of the sustainability performance of a reporting organization – including both positive and negative contributions.

There are three elements of the GRI Sustainability Reporting Guidelines, viz. Reporting Principles, Reporting Guidance and Standard Disclosures (including performance indicators). These three elements are considered to be equal in weight and importance.

The steps to use the GRI Reporting Framework are as follows:

1. Identify the topics and related indicators that are relevant by undergoing an interactive process using the Principles of materiality and stakeholder inclusiveness, sustainability context, and Report Boundaries.
2. When identifying the topics consider the relevance of all indicator aspects identified in the GRI Guidelines and applicable sector supplements.
3. From the set of relevant topics and indicators, use the tests listed for each Principle to assess which topics and indicators are material.
4. Use the Principles to prioritize selected topics and decide which will be emphasized.
5. The specific methods or processes used for assessing materiality be—
 - Differentiated for and indentified by each organization.
 - Dependent on the guidance and tests found in the GRI Reporting Principles, and
 - Disclosed.

Answer 8(iii)

The Dow Jones Sustainability Indices are the first global indices tracking the financial performance of the leading sustainability-driven companies worldwide, it was launched in 1999.

The Dow Jones Sustainability World Index (DJSI World) comprises more than 300 companies that represent the top 10% of the leading sustainability companies out of the biggest 2500 companies in the Dow Jones World Index.

Corporate Sustainability Assessment Criteria under the Dow-Jones Indices is as under:

<i>Dimension</i>	<i>Criteria</i>	<i>Weighting (%)</i>
Economic	Codes of Conduct / Compliance /	
	Corruption & Bribery	5.5
	Corporate Governance	6.0
	Risk & Crisis Management	6.0
	Industry Specific Criteria	Depends on Industry
Environment	Environmental Performance	
	(Eco-Efficiency)	7.0
	Environmental Reporting*	3.0
	Industry Specific Criteria	Depends on Industry
Social	Corporate Citizenship/ Philanthropy	3.5
	Labor Practice Indicators	5.0
	Human Capital Development	5.5

Social Reporting*	3.0
Talent Attraction & Retention	5.5
Industry Specific Criteria	Depends on Industry

Documents analyzed include:

- Sustainability reports
- Environmental reports
- Health and safety reports
- Social reports
- Annual financial reports
- Special reports (e.g. on intellectual capital management, corporate governance, R&D, employee relations)
- All other sources of company information; e.g. internal documentation, brochures and website.

Answer 8(iv)

The Convention on Biological Diversity, known informally as the Biodiversity Convention, is an international treaty that was adopted in Rio de Janeiro in June 1992. The Convention has three main goals:

1. conservation of biological diversity;
2. sustainable use of its components; and
3. fair and equitable sharing of benefits arising from genetic resources.

In other words, its objective is to develop national strategies for the conservation and sustainable use of biological diversity. It is often seen as the key document regarding sustainable development.

Some of the issues dealt with under the convention include:

- Measures and incentives for the conservation and sustainable use of biological diversity.
- Regulated access to genetic resources and traditional knowledge, including Prior Informed Consent of the party providing resources.
- Sharing, in a fair and equitable way, the results of research and development and the benefits arising from the commercial and other utilization of genetic resources with the Contracting Party providing such resources (governments and/or local communities that provided the traditional knowledge or biodiversity resources utilized).
- Access to and transfer of technology, including biotechnology, to the governments and/or local communities that provided traditional knowledge and/or biodiversity resources.

- Technical and scientific cooperation.
- Impact assessment.
- Education and public awareness.
- Provision of financial resources.
- National reporting on efforts to implement treaty commitments.

Answer 8(v)**Case-laws on Water Pollution**

The *M C Mehta v. Union of India* (AIR 1988 SC 1037) also known as The Kanpur Tanneries or Ganga Pollution case is among the most significant water pollution case. Detailed scientific investigations and the reports were produced before the Court of Evidence. The Supreme Court held:

“Where in public interest litigation owners of some of the tanneries discharging effluents from their factories in Ganga and not setting up a primary treatment plant in spite of being asked to do so for several years did not care, in spite of notice to them, even to enter appearances in the Supreme Court to express their willingness to take appropriate steps to establish the pre-treatment plants it was held that so far as they were concerned on order directing them to stop working their tanneries should be passed. It was observed that the effluent discharged from a tannery is ten times noxious when compared with the domestic sewage water which flows into the river from any urban area on its bank. It was further observed that the financial capacity of the tanneries should be considered as irrelevant while requiring them to establish primary treatment plants.

In *Vineet Kumar Mathur v. Union of India* [(1996) 1 SCC 119], the Court took note of the continued violation of the State, as well as industries by continuing to pollute water by discharging effluents and also in not setting up of common effluent treatment plants. The Court initially directed the officers of the State Pollution Board to visit the polluting industrial establishments and make a fresh inspection of the Effluent Treatment Plants installed in the said establishments and of their working. After inspection, if it was found that the treatment plants are deficient in any respect or the deficiency pointed out earlier still continues, the Board will give reasonable time for the industries to cure the deficiencies. However, the time so given should not extend beyond the deadline set up by the Court. The Board was directed to file its report within fifteen days. The Court further held that if the industries do not obtain the consent of the State Pollution Board for running their units, before the fixed time limit the industries will stop functioning there after.
