

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) *“Good governance is decisively the manifestation of personal beliefs and values which configure the organisational values, beliefs and actions of the Board. A properly structured Board capable of taking independent and objective decisions is the pivot of Corporate Governance. A Board should, therefore, be a mix of executive and independent directors with a variety of experience and core competence so that the Board may effectively fulfil their responsibilities by laying down policies and strategies and monitoring managerial performance objectively.”*

In the light of above statement, discuss the role of independent directors in the Corporate Governance and state the provisions of the Companies Act, 1956 and the listing agreement with regard to appointment of independent directors on the Board of directors of a listed company.

(10 marks)

- (b) *State, with reasons in brief, whether the following statements are true or false :*
- (i) Section 275 of the Companies Act, 1956 stipulates that a person cannot hold office as director in more than fifteen companies at the same time.*
 - (ii) Control activities are the policies and procedures which ensure that management directives are carried out.*
 - (iii) Internal auditors play an important role in evaluating the effectiveness of control systems and contribute to ongoing effectiveness.*
 - (iv) Codification of Corporate Governance in India started with the recommendations of Kumar Mangalam Birla Committee.*
 - (v) Corporate social responsibility is distinct from corporate philanthropy.*

(2 marks each)

Answer 1(a)

Independent directors are known to bring an objective view in board deliberations. They also ensure that there is no dominance of one individual or special interest group or the stifling of healthy debate. They 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. They contribute significantly to the decision-making process of the Board. They can bring an objective view to the evaluation of the performance of Board and management. In addition, they can play an important role in areas where the interest of management,

the company and shareholders may diverge such as executive remuneration, succession planning, changes in corporate control, audit function etc.

Independent directors are required because they perform the following important role :

- (i) Balance the often conflicting interests of the stakeholders.
- (ii) Facilitate withstanding and countering pressures from owners.
- (iii) Fulfill a useful role in succession planning.
- (iv) Act as a coach, mentor and sounding Board for their full time colleagues.
- (v) Provide independent judgment and wider perspectives.

The Board Composition in terms of Clause 49 of the Listing Agreement should be as under:

- (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.
- (ii) Where the Chairman of the Board is a non-executive director, at least one-third of the Board should comprise of independent directors and in case he is an executive director, at least half of the Board should comprise of independent directors.

Provided that where the non-executive Chairman is a promoter of the company or is related to any promoter or person occupying management positions at the Board level or at one level below the Board, at least one-half of the Board of the company shall consist of independent directors.

Explanation - For the purpose of the expression “related to any promoter” referred to in sub-clause (ii):

- (a) If the promoter is a listed entity, its directors other than the independent directors, its employees or its nominees shall be deemed to be related to it;
- (b) If the promoter is an unlisted entity, its directors, its employees or its nominees shall be deemed to be related to it.”
- (iii) For the purpose of the sub-clause (ii), the expression ‘independent director’ shall mean a 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 directors, its senior management or its holding company, its subsidiaries and associates which may affect independence of the director;
 - (b) is not related to promoters or persons occupying management positions 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 or was not partner or an executive during the preceding three years, of any of the following:
 - (i) the statutory audit firm or the internal audit firm that is associated with the company, and
 - (ii) the legal firm(s) and consulting firm(s) that have a material association with the company.
- (e) is not a material supplier, service provider or customer or a lessor or lessee of the company, which may affect independence of the director;
- (f) is not a substantial shareholder of the company i.e. owning two percent or more of the block of voting shares;
- (g) is not less than 21 years of age.

Explanation

For the purposes of the sub-clause (iii):

- (a) Associate shall mean a company which is an “associate” as defined in Accounting Standard (AS) 23, “Accounting for Investments in Associates in Consolidated Financial Statements”, issued by the Institute of Chartered Accountants of India.
- (b) “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.
- (c) “Relative” shall mean “relative” as defined in section 2(41) and section 6 read with Schedule IA of the Companies Act, 1956.
- (d) Nominee directors appointed by an institution which has invested in or lent to the company shall be deemed to be independent directors.

Explanation

“Institution for this purpose means a public financial institution as defined in Section 4A of the Companies Act, 1956 or a “corresponding new bank” as defined in section 2(d) of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 or the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 [both Acts].”

The Companies Act, 1956 does not define independent director. However, independent director has been referred in Schedule XIII to the Companies Act, 1956, wherein it is referred in connection with the composition of Remuneration Committee.

Answer 1(b)(i)

True: Section 275 of the Companies Act, 1956 restricts the number of directorship held by an Individual. It provides that after the commencement of this Act, no person shall, save as otherwise provided in section 276, hold office at the same time as director in more than fifteen companies.

Further, Sec. 278 of the Companies Act, 1956 provides for exclusion of certain directorships for the purpose of Sec. 275 whereby the following companies are excluded:

- (a) a private company which is neither a subsidiary nor a holding company of a public company;
- (b) an unlimited company;
- (c) an association not carrying on business for profit or which prohibits the payment of a dividend;
- (d) a company in which such person is only an alternate director, that is to say, a director who is only qualified to act as such during the absence or incapacity of some other director.

Answer 1(b)(ii)

True : A component of COSO'S Internal Control Framework, control activities are the policies and procedures that help to ensure management directives are carried out. It helps to ensure that necessary actions are taken to address risks to achievement of the entity's objectives. Control activities occur throughout the organization, at all levels and in all functions. They include a range of activities as diverse as approvals, authorizations, verifications, reconciliations, review of operating performance, security of assets and segregation of duties.

Answer 1(b)(iii)

True : Internal auditors play an important role in evaluating the effectiveness of control systems, and contribute to ongoing effectiveness. Because of organizational position and authority in an entity, an internal audit function often plays a significant monitoring role.

Answer 1(b)(iv)

True : The Kumar Mangalam Birla Committee Report was the first formal and comprehensive attempt to evolve a Code of Corporate Governance, in the context of prevailing conditions of governance in Indian companies, as well as the state of capital markets at that time.

The recommendations of the Kumar Mangalam Birla Committee, led to inclusion of Clause 49 in the Listing Agreement in the year 2000. These recommendations, aimed at improving the standards of Corporate Governance, are divided into mandatory and non-mandatory recommendations.

Answer 1(b)(v)

True : Philanthropy means the act of donating money, goods, time or effort to support a charitable cause in regard to a defined objective. Philanthropy can be equated with benevolence and charity for the poor and needy. Philanthropy can be by an individual or by a corporate.

Corporate Social Responsibility on the other hand 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. 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 drives the CSR initiatives in companies.

Question 2

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

- (i) Two-tier Board
- (ii) Whistle blower policy
- (iii) Shareholder activism
- (iv) Corporate Governance Committee. (3 marks each)

(b) You are the Company Secretary of Nodal Power Company Ltd. Your Board of directors wants to understand its responsibilities for reviewing the company's policies on risk oversight and management in the light of listing agreement and satisfy itself whether the management has developed and implemented a sound system of risk management and control.

Prepare a Board note discussing the responsibilities of the Board on risk management and the relevant legal provisions on risk management under the listing agreement. (6 marks)

Answer 2(a)(i)

Two-tier Boards

The two-tier board was developed in its present form in Germany. In a two-tier board there is clear separation between the tasks of monitoring and that of management. The supervisory board (Aufsichtsrat) oversees the direction of the business and the management board (Vorstand) is responsible for the running of the company. The supervisory board controls the management board through appointing its members and through its statutory right to have the final say in major decisions affecting the company. The structure rigorously separates the control function from the management function and members of the one board cannot be members of the other. This separation is enshrined in law and the legal responsibilities of the two sets of board members are different.

The supervisory board system was introduced to strengthen the control of shareholders, particularly the banks, over the companies in which they had invested. Shareholdings are more concentrated in Germany and most quoted companies have at least one major shareholder, often a family or another company. Banks play an important part in governance as investors, lenders and through the votes of individual shareholders for which they hold proxies. They are, therefore, well represented on supervisory boards.

The supervisory board, may have to approve management action, but it is primarily a monitoring body not an initiatory one.

Answer 2(a)(ii)

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 of the mechanism and also provide for 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 of clause 49 of Listing Agreement. In case the whistle Blower mechanism is existing, the audit committee is responsible to review the functioning of the Whistle Blower mechanism and a disclosure should be made in the Annual Report about the Whistle Blower policy and affirmation that no personnel has been denied access to the audit committee.

Answer 2(a)(iii)

Shareholder activism

Shareholder activism refers to the active involvement of stockholders in the organizations they have invested in. Active participation in company meetings is a healthy practice. Shareholders can ensure that the company follows good corporate governance practices and implements beneficial policies. They can resolve issues laid down in the annual and other general meetings and can raise concerns over financial matters or even social causes such as protection of the environment. Shareholder activists include public pension funds, mutual funds, unions, religious institutions, universities, foundations, environmental activists and human rights groups.

The shareholder activism means

- Establishing dialogue with the management on issues that concern
- Influencing the corporate culture.
- Using the corporate democracy provided by law.
- Increasing general awareness on social and human rights issues concerning the organization.

Answer 2(a)(iv)

Corporate Governance Committee

A company may constitute Corporate Governance Committee to develop and recommend the board a set of corporate governance guidelines applicable to the company, implement policies and processes relating to corporate governance principles, to review, periodically, the corporate governance guidelines of the company. Many companies give the mandate of corporate governance to nomination committee and is given the nomenclature Nomination and Corporate Governance Committee.

Typically, Corporate Governance Committee is responsible for considering matters relating to corporate governance including the composition of board, appointment of new directors, review of strategic human resource decisions, succession planning for the chairman and other key board and executive positions, performance evaluation of the board and its committees and individual directors.

Answer 2(b)**Board of Directors****Nodal Power Company Limited.***Sub : Note on Risk Management*

Risk management, in the business context, covers the processes and activities undertaken by an organization to identify, analyse, assess, control and mitigate potential risks and its impact.

The board is responsible for reviewing the company's policies on risk oversight and management and satisfying itself that management has developed and implemented a sound system of risk management and internal control.

The entire programme must be supported by the board of directors. In larger companies, the board desirably has a risk management committee which controls the overall picture of the uncertainty facing the company. This is because risks are interconnected and interdependent. The approach must include all elements of risks. The traditional elements of potential likelihood and potential consequences of an event must be combined with other factors like the timing of the risks, the correlation of the possibility of an event occurring with others, and the confidence in risk estimates.

Risk management policies should reflect the company's risk profile and should clearly describe all elements of the risk management and internal control system and any internal audit function.

A company's risk management policies should clearly describe the roles and accountabilities of the board, audit committee, or other appropriate board committee, management and any internal audit function.

A company may designate a Chief Risk Officer manned by an individual with the vision and the diplomatic skills to forge a new approach. He may be supported by "risk groups" to oversee the initial assessment work and to continue the work till it is completed.

An integrated approach to risk management deals with various risks as they affect organizational objectives and limitations. The aim must be to develop a culture of risk awareness and understanding. This helps better decision making in day-to-day work by all employees.

Legal Provisions on Risk Management under the Listing Agreement

In terms of Clause 49 of the Listing Agreement

- the company shall lay down 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.
- Management Discussion & Analysis should include discussion on
 1. Risks and concerns.
 2. Internal control systems and their adequacy.

Sd/-

Company Secretary

Question 3

- (a) *“Constructive insiders are also liable for insider trading violations if the company expects the information to remain confidential, since they acquire the fiduciary duties of the true insiders.” Discuss the statement in the light of decided cases.* (7 marks)
- (b) *Describe how the OECD principles of Corporate Governance helped in evolution and development of Corporate Governance.* (4 marks)
- (c) *“Chairmen have no legal position.” Elucidate.* (4 marks)

Answer 3(a)

The Dirks case in USA also defined the concept of “constructive insiders,” to include lawyers, investment bankers and others who receive confidential information from a corporation while providing services to the corporation. Constructive insiders are also liable for insider trading violations if the corporation expects the information to remain confidential, since they acquire the fiduciary duties of the true insider.

In 1984, the Supreme Court of the United States ruled in the case of *Dirks v. SEC* that tippees (receivers of second-hand information) are liable if they had reason to believe that the tipper had breached a fiduciary duty in disclosing confidential information and the tipper received any personal benefit from the disclosure. (Since Dirks disclosed the information in order to expose a fraud, rather than for personal gain, nobody was liable for insider trading violations in his case.)

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

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. This system is expected to help it detect potential and accomplished insider trading and manipulation or fraud violations across financial instruments and markets.

Answer 3(b)**OECD principles of Corporate Governance**

The Organisation for Economic Co-operation and Development (OECD) was established in 1961. The OECD was one of the first non-government organizations to spell out the principles that should govern corporates.

The OECD Principles of Corporate Governance set out a framework for good practice which was agreed by the governments of the 30 countries that are members of the OECD. They were designed to assist governments and regulatory bodies in both OECD countries and elsewhere in drawing up and enforcing effective rules, regulations and codes of corporate governance. They also provide guidance for stock-exchanges, investors, companies and others that have a role in the process of developing good corporate governance.

The original OECD Principles were issued in 1999, they became a generally accepted standard in this area. The original principles of OECD were revised and the revised principles were issued in 2004. The revision of the original principles was to take into account the developments and the corporate governance scandals highlighted the need for improved standards. It was recognized that the integrity of the stock market was critical and to the revised principles were designed to underpin this integrity.

The OECD Principles of Corporate Governance cover six main areas.

- (a) They call on governments to have in place an effective institutional and legal framework to support good corporate governance practices .
- (b) They call for a corporate governance framework that protects and facilitates the exercise of shareholders' rights .
- (c) They also strongly support the equal treatment of all shareholders, including minority and foreign shareholders.
- (d) They recognise the importance of the role of stakeholders in corporate governance.
- (e) They look at the importance of timely, accurate and transparent disclosure mechanisms
- (f) They deal with board structures, responsibilities and procedures.

The OECD Principles of Corporate Governance has provided governments, regulators and other standard setters with an international benchmark. The OECD works closely with a large number of developing and emerging market countries. In particular, the OECD organises Regional Corporate Governance Roundtables in Asia, Latin America, Eurasia, Southeast Europe and Russia. These Roundtables have used the OECD Principles to formulate regional reform priorities and are now actively engaged in implementing these recommendations.

Answer 3(c)

The responsibility for ensuring that boards provide the leadership which is expected of them is that of their chairmen. Chairmen, however, have no legal position; they are whoever the board elects to take the chair at a particular meeting. Boards are not bound to continue with the same chairman for successive meetings. In law, all directors have broadly equal responsibilities and chairmen are no more equal than any other board member. Chairmen are an administrative convenience and a means of ensuring that board meetings are properly conducted.

Thus from a statutory point, in terms of Companies Act, 1956, of view there is no necessity for a board to have a continuing chairman. The chairmanship could, for example, rotate among board members. Although board chairmen have no statutory position, the choice of who is to fill that post is crucial to board effectiveness. If the chairman is not upto the task, it is improbable that the meeting will achieve anything but frustration and waste of that most precious of resources—time. Continuity and competence of Chairmanship is vital to the contribution which boards make to their companies.

On the other hand, in terms of Clause 49 of the listing agreement, the composition of board (i.e. proportion of independent directors in the board) is dependent upon whether the Chairman is executive or non-executive as also whether the chairman is a promoter or relative of promoter.

Question 4

- (a) *You are the Company Secretary of Beware Ltd., listed in the London Stock Exchange. Prepare a brief note to the Chairman highlighting the relevant provisions of the UK Combined Code on Corporate Governance stating the factors determining independence of the directors under the UK law. (7 marks)*
- (b) *“The institutional investors use different tools to assess the health of the company before making investment of funds.” Discuss some of the important tools used by the institutional investors for this purpose. (4 marks)*
- (c) *“Corporate communication comprises both — external as well as internal communication.” Elaborate this statement. (4 marks)*

Answer 4(a)

The Chairman Beware Ltd.

Sub: Note on factor determining Independence of Directors

Corporate governance regulation and practice is deeply-routed in the UK. The first mainstream best practice corporate governance codes were published in the early 1990s and there has been a Combined Code against which listed companies have to report, on the comply or explain basis, since 1998. Key aspects of corporate governance in the UK are:

- a single board with checks and balances;
- effective rights for shareholders;
- transparency; and
- a best practice code on corporate governance, operating on a comply or explain basis.

The Combined Code is voluntary. However, the Listing Rules require UK incorporated listed companies, in their annual accounts, to (i) report on how they apply its main principles and (ii) either confirm that they comply with its detailed provisions or explain their non-compliance (known as the “comply or explain” basis).

Board Structure

The code requires that at least half the board, excluding the chairman, should comprise independent non-executive directors. A smaller company should have at least two independent non-executive directors.

Criteria for independence of director

The following factors are relevant in determining the independence of 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;
- 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

The code requires the board to 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 have remained unresolved in spite of taking up with chairman, chief executive or finance director.

Further, the UK Code provides for the constitution of following committees:

- Audit Committee
- Remuneration Committee
- Nomination Committee

Sd/-

Company Secretary

Answer 4(b)

Tools Used by Institutional Investors

The Institutional Investors use different tools to assess the health of company before investing resources in it. Some of the important tools are discussed as under:

(i) *One-to-one meetings*

The meetings between institutional investors and companies are extremely important as a means of communication between the two parties. This is one clear example of the way that individual investors are at a disadvantage to institutional investors as corporate management will usually only arrange such meetings with large investors who are overwhelmingly institutional investors. A company will usually arrange to meet with its largest institutional investors on a one-to-one basis during the course of the year

(ii) *Voting*

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. Most of the large institutional investors now have a policy of trying to vote on all issues which may be raised at their investee company's AGM. Some may vote directly on all resolutions, others may appoint a proxy (which may be a board member).

(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. Underperforming the index would be a first point of identification, other factors would include not responding appropriately to the institutional investor's enquiries regarding underperformance, and not taking account of the institutional investor's views. 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*

With the increasing emphasis on corporate governance across the globe, it is perhaps not surprising that a number of corporate governance rating systems have been developed. These corporate governance rating systems should be of benefit to investors, both potential and those presently invested, and to the companies themselves.

In turn, 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. In emerging market countries in particular, those companies with a corporate governance infrastructure will, *ceteris paribus*, be less subject to cronyism and its attendant effects on corporate wealth. These companies would tend to be more transparent and accountable, and hence more attractive to foreign investors.

Answer 4(c)

Corporate communication means the corporation's voice and the images it projects of itself to the various stakeholders. This includes various areas such as corporate reputation, corporate advertising, and employee communications, government relations and media management. These days most of the bigger organizations have departments of corporate communication which appears on the organizational chart along with traditional functions like marketing or accounting.

The corporate communication can also be defined as the processes a company uses to communicate all its messages to key constituencies –

- a combination of meetings,
- interviews,
- speeches,
- reports,
- images

- advertising, and
- on-line communication.

Corporate communication comprises both external and internal communications. The external communication may be media relation, an external event, company profiling etc. Internal communication would be addressed to employees, crisis management and so on.

(a) *Media Relations*

This involves building and maintaining a positive relationship with the media (TV, print, web etc. Be it drafting and dissemination of press releases, organizing press conferences and meeting with media professionals, events for media etc.

(b) *External event*

Could involve vendor/supplier/distributor meets, channel partner meetings, events related to product launches, important initiatives etc.

(c) *Company/Spokesperson profiling*

Ensuring that the company/organization spokesperson is in the public limelight, is well-known and considered as an authority for the respective sector/field.

- Management of company internet/web portals/other external touch points
- Managing company publication - for the external world manage Print Media

(d) *Internal communications*

- Managing company publication - for employees and partners

(e) *Employee communications*

- Sharing information with employees, building employer pride, managing employee issues, etc.
- Manage Intranet and other internal web portals

(f) *Brand management*

- Develop and upkeep the corporate identity - ensure adherences to corporate brand guidelines

(g) *Crisis communication*

- Manage crisis situations through effective communication

PART B

(Answer **any two** questions from this part.)

Question 5

- (a) *You are the Company Secretary of Dia Pipes Ltd. The Board of directors desires to know from you the 'best practices in ethics programme'. Draft a precise ten point best practices in ethics programme for consideration of the Board of directors.* (7 marks)

- (b) *Discuss the concept of 'ethics philosophies'.* (4 marks)
- (c) *"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." In the light of this statement, enumerate the CRT general principles for business.* (4 marks)

Answer 5(a)

Board of Directors Dia Pipes Limited

Sub: Best Practices in Ethics Programme

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. Following are the best practices which should be considered in Ethics programme:

- Constitute an ethics committee. The recommendations of the ethics committee should include staff training, evaluations of compliance systems, appropriate funding and staffing of the corporate ethics office, and effective protections to employees who "blow the whistle" on perceived actions contrary to the spirit and/or letter of the Code.
- Annual training on the code is a good practice. Many corporations establish independent "hot lines" or "help lines" where employees can seek guidance when they are faced with an ethical dilemma or when they encounter unethical conduct in the workplace.
- Establishing a regular review system to ensure the Code is dynamic and updated in the light of new developments.
- Every member of the Board of Directors should be required to sign the Code of Ethics and pledge that she or he will never support a Board motion to suspend the Code.
- All outside law firms and auditing firms that consult to publicly listed corporations should be required to sign statements noting that they understand and accept the corporation's Code of Ethics.
- Employees basically want to know two things- (a) know what is expected or required for them to survive and to be successful (b) know "how they were doing" at that point in time.

The following - Goals, Roles, Expectations and Priorities should be communicated to the employees:

- People should be reminded/repeatedly communicated of the short term and long term goals of the job. They should see how their goals support the organization's mission and vision. Employees should be made aware that how a goal is accomplished was just as important as accomplishing the goal itself. Cutting corners could hurt the corporation, its reputation and, eventually, the individual employee.

- Employees should know how their job fits into the bigger picture which will remind them of their importance and value ensure that they understand their role and ensure that they understand what kind of conduct was expected is very important.
- Employees should understand exactly what was expected, what had to be done, when, to what standards, how would it be evaluated, what should they do if they encountered any hurdle or unanticipated changes, how conflicts should be handled.
- Employees should have clarity of the organization's operational priorities.

XYZ

Company Secretary

Answer 5(b)

The following are some of the ethics philosophies:

Deontological ethics or deontology [Greek : (*deon*) meaning 'obligation' or 'duty'] is an approach to ethics that focuses on the rightness or wrongness of actions themselves, as opposed to the rightness or wrongness of the consequences of those actions. Thus, the term 'deontological' picked out the set of ethical theories that are based on the idea that an action's being right or wrong is basic, and whether a situation is good or bad depends on whether the action that brought it about was right or wrong. This can be clarified with an example – if a manager decides that it is his duty to always be on time to meetings is running late for reasons not in his control, how is he supposed to drive to reach the meeting on time ? Is he supposed to speed, breaking his duty to uphold the law, or is he supposed to arrive at his meeting late, breaking his duty to be on time ?

Teleology (Greek : *telos*: end, purpose) is the philosophical study of design and purpose. A teleological school of thought is one that holds all things to be designed for or directed toward a final result, that there is an inherent purpose or final cause for all that exists.

Enlightened-egoism. This model takes into account harms, benefits and rights. Therefore, under this model an action is morally correct if it increases benefits for the individual in a way that does not intentionally hurt others, and if these benefits are believed to counterbalance any unintentional harms that ensue. For example, a company provides scholarships for education to needy students with a condition that the beneficiary is required to compulsorily work for the company for a period of 5 years. Although, the company's providing the scholarship benefits the needy students, but ultimately it is in the company's self interest.

Utilitarianism is the idea that the moral worth of an action is solely determined by its contribution to overall utility, that is, its contribution to happiness or pleasure as summed among all persons. It can be described by the phrase "the greatest good for the greatest number". For example, one may be tempted to steal from a rich wastrel to give to a starving family.

Relativism is the idea that some elements or aspects of experience or culture are relative to, i.e., dependent on, other elements or aspects. The term often refers to truth relativism, which is the doctrine that there are no absolute truths, i.e., that truth is always relative to some particular frame of reference, such as a language or a

culture. For example, killing animals for sport (like bull fighting) could be right for one culture and wrong in another culture.

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.

Justice is the concept of moral rightness in action or attitude; it is closely linked to fairness. A conception of justice is one of the key features of society.

Answer 5(c)

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.

These principles are rooted in two basic ethical ideals: *kyosei* and human dignity. The Japanese concept of “*kyosei*” means living and working together for the common good enabling cooperation and mutual prosperity to coexist with healthy and fair competition.

“Human dignity” refers to the sacredness or value of each person as an end, not simply as a mean to the fulfillment of others' purposes or even majority prescription. These principles are as follow:

Principle 1

The Responsibilities of Businesses: Beyond Shareholders toward Stakeholders

Principle 2

The Economic and Social Impact of Business: Toward Innovation, Justice and World Community

Principle 3

Business Behavior: Beyond the Letter of Law : Toward a Spirit of Trust

Principle 4 - Respect for Rules

Principle 5 - Support for Multilateral Trade

Principle 6 - Respect for the Environment

Principle 7 - Avoidance of Illicit Operations

Question 6

- (a) *“The Board of directors holds ultimate responsibility for their company’s success or failure as well as for ethics of their decisions.” In the light of this statement, discuss the role of Board of directors in shaping the ethical climate of a company.*
(7 marks)

(b) *Elaborate the concept of ‘stakeholders’.* (4 marks)

(c) *Write a note on ‘social and ethical accounting’.* (4 marks)

Answer 6(a)

Role of Board of Directors in Shaping the Ethical Climate

The board of directors hold the ultimate responsibility for their firm’s success or failure, as well as for ethics of their actions. The ethical tone of an organization is set at the top, the actions and attitudes of the board greatly influence the ethical climate of an organization. What top management does, and the culture they establish and reinforce, makes a huge difference in the way lower-level employees act and in the way the organization as a whole acts when ethical dilemmas are faced. When the ethical climate is not clear and positive, ethical dilemmas will often result in unethical behavior.

The directors on a company’s board assume legal responsibility for the firm’s resources and decisions. Board members have a fiduciary duty, i.e. a position of trust and confidence. Due to globalization, the role of the media, technology revolutionizing the nature and speed of communication, directors are feeling greater demands for accountability and transparency. This calls for ethical decision making and providing an ethical decision making framework.

The perspective and independent judgement of independent directors can be helpful in determining a company’s approach towards ethical issues and stakeholder interests. Independent directors are in a position to challenge current practices and also contribute knowledge and experience of good practices.

A Report by the Conference Board Commission on Public Trust and Private Enterprise suggested the following areas of oversight by a Board:

- Designation of a Board committee to oversee ethics issues;
- Designation of an officer to oversee ethics and compliance with the code of ethics;
- Inclusion of ethics-related criteria in employees’ annual performance reviews and in the evaluation and compensation of management;
- Representation by senior management that all known ethics breaches have been reported, investigated, and resolved; and
- Disclosure of practices and processes the company has adopted to promote ethical behavior.

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.

Stakeholders provide resources that are more or less critical to a firm’s long-term success. These resources may be both tangible and intangible. Shareholders, for example,

supply capital; suppliers offer material resources or intangible knowledge; employees and managers grant expertise, leadership, and commitment; customers generate revenue and provide infrastructure; and the media transmits positive corporate images.

The classic definition of a stakeholder is 'any group or individual who can affect or is affected by the achievement of the organization's objectives (Freeman 1984:46).

The 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.

Another definition given subsequently by Freeman of Stakeholder: "Those groups who are vital to the survival & success of the corporation" and the two principles were altered and 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

Two types of Stakeholders

Primary stakeholders are those whose continued association is absolutely necessary for a firm's survival; these include employees, customers, investors, and shareholders, as well as the governments and communities that provide necessary infrastructure.

Secondary stakeholders do not typically engage in transactions with a company and thus are not essential for its survival; these include the media, trade associations, and special interest groups.

Answer 6(c)

Social and Ethical Accounting

Social and ethical accounting is a process that helps a company to address issues of accountability to stakeholders, and to improve performance of all aspects i.e. social, environmental and economic. The process normally links a company's values to the development of policies and performance targets and to the assessment and communication of performance.

Social and ethical accounting has no standardized model. There is no standardized

balance sheet or unit of currency. The issues are defined by the company's values and aims by the interests and expectations of its stakeholders, and by societal norms and regulations. With the focus on the concerns of society, the social and ethical accounting framework implicitly concerns itself with issues such as economic performance, working conditions, environmental and animal protection, human rights, fair trade and ethical trade, human resource management and community development, and hence with the sustainability of a company's activities.

Principles of social and ethical accounting

The dominant principle of social and ethical accounting is inclusivity. This principle requires that the aspirations and needs of all stakeholder groups are taken into account at all stages of the social and ethical accounting process.

- *Planning* : The company commits to the process of social and ethical accounting, auditing and reporting, and defines and reviews its values and social and ethical objectives and targets.
- *Accounting* : The scope of the process is defined, information is collated and analysed, and performance targets and improvement plans are developed.
- *Reporting* : A report on the company's systems and performance is prepared.
- *Auditing* : The process of preparing the report and the report itself are externally audited, and the report is made accessible to stakeholders in order to obtain feedback from them.
- *Embedding* : To support each of the stages, structures and systems are developed to strengthen the process and to integrate it into the company's activities.
- *Stakeholder engagement* : The concerns of stakeholders are addressed at each stage of the process through regular involvement.

The nature of social and ethical reporting is related to the size and nature of the organization. However comprehensive and clear a report is, it needs to be trusted to be valuable.

Question 7

- (a) *Your company is listed in the Bombay Stock Exchange. There is a proposal to set-up its business in USA. You are required to prepare a brief note for the Chairman explaining the code of conduct and business ethics in both the countries.* (7 marks)
- (b) *Discuss the Clarkson Principle of Stakeholder Management.* (4 marks)
- (c) *Write a note on 'ethics training and communication'.* (4 marks)

Answer 7(a)

**The Chairman
XYZ Limited**

Sub: Note on Code of Conduct and Business Ethics

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.

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 of Regulation S-K which is a prescribed regulation under the US Securities Act, 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.

Code of Conduct

Code of conduct popularly known as Code of Business Conduct contains standards of business conduct that must guide actions of the Board and senior management of the Company.

The Code may include the following:

- (a) Company Values.
- (b) Avoidance of conflict of interest.
- (c) Accurate and timely disclosure in reports and documents that the company files before Government agencies, as well as in Company's other communications.
- (d) Compliance of applicable laws, rules and regulations including Insider Trading Regulations.
- (e) Maintaining confidentiality of Company affairs.
- (f) Non-competition with Company and maintaining fair dealings with the Company.
- (g) Standards of business conduct for Company's customers, communities, suppliers, shareholders, competitors, employees.
- (h) Prohibition of Directors and senior management from taking corporate opportunities for themselves or their families.
- (i) Review of the adequacy of the Code annually by the Board.
- (j) No authority of waiver of the Code for anyone should be given.

The Code of Conduct for each Company summarises its philosophy of doing business.

To create a code of ethics, an organization must define its most important guiding values, formulate behavioral standards to illustrate the application of those values to the roles and responsibilities of the persons affected, review the existing procedures for guidance and direction as to how those values and standards are typically applied, and establish the systems and processes to ensure that the code is implemented and effective. Codes of ethics are not easily created from boilerplate. Ideally, the development of a code will be a process in which Boards and senior management actively debate and decide core values, roles, responsibilities, expectations, and behavioral standards.

Sd/-

(ABC)

Answer 7(b)

The Clarkson Principles emerged from a project undertaken by the Centre for Corporate Social Performance and Ethics:

Principle 1: Managers should acknowledge and actively monitor the concerns of all legitimate stakeholders, and should take their interests appropriately into account in decision-making and operations.

Principle 2: Managers should listen to and openly communicate with stakeholders about their respective concerns and contributions, and about the risks that they assume because of their involvement with the corporation.

Principle 3: Managers should adopt processes and modes of behavior that are sensitive to the concerns and capabilities of each stakeholder constituency.

Principle 4: Managers should recognize the interdependence of efforts and rewards among stakeholders, and should attempt to achieve a fair distribution of the benefits and burdens of corporate activity among them, taking into account their respective risks and vulnerabilities.

Principle 5: Managers should work cooperatively with other entities, both public and private, to insure that risks and harms arising from corporate activities are minimized and, where they cannot be avoided, appropriately compensated.

Principle 6: Managers should avoid altogether activities that might jeopardize inalienable human rights (e.g., the right to life) or give rise to risks which, if clearly understood, would be patently unacceptable to relevant stakeholders.

Principle 7: Managers should acknowledge the potential conflicts between (a) their own role as corporate stakeholders, and (b) their legal and moral responsibilities for the interests of all stakeholders, and should address such conflicts through open communication, appropriate reporting and incentive systems and, where necessary, third party review.

Answer 7(c)

Ethics Training and Communication

A major step in developing an effective ethics program is implementing a training

program and communication system to communicate and educate employees about the firm's ethical standards.

Training can educate employees about the firm's policies and expectations, as well as relevant laws and regulations and general social standards. Training programs can make employees aware of available resources, support systems, and designated personnel who can assist them with ethical and legal advice. They can also empower employees to ask tough questions and make ethical decisions. Many companies are now incorporating ethics training into their employee and management development training efforts.

If ethics training is to be effective, it must start with a foundation, a code of ethics, a procedure for airing ethical concerns, line and staff involvements, and executive priorities on ethics that are communicated to employees. Managers from every department must be involved in the development of an ethics training program. Training and communication initiatives should reflect the unique characteristics of an organization: its size, culture, values, management style, and employee base. It is important for the ethics program to differentiate between personal and organizational ethics.

To be successful, business ethics programs should educate employees about formal ethical frameworks and more for analyzing business ethics issue. Then employees can base ethical decisions on their knowledge of choices rather than on emotions.

Written standards deter wrongdoing and promote:

1. Honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;
2. Full, fair, accurate, timely, and understandable disclosure in reports and documents that a company files with, or submits to, the Commission and in other public communications made by the [company];
3. Compliance with applicable governmental laws, rules and regulations;
4. The prompt internal reporting of violations of the code to an appropriate person or persons identified in the code; and,
5. Accountability for adherence to the code.

PART C

Question 8

Attempt any four of the following :

- (i) *"The International Labour Organisation (ILO) is the only tripartite United Nations agency that brings together representatives of governments, employers and workers to jointly shape policies and programmes to achieve its defined objectives." Elucidate.*
- (ii) *Write a note on 'hazardous or inherently dangerous industry'.*
- (iii) *"Just like an industry which cannot pay minimum wages to its workers cannot be allowed to exist, a tannery which cannot set-up a primary treatment plant cannot be permitted to continue to be in existence for the adverse effects on the public at large." Discuss this statement with the relevant case law.*

- (iv) *“Corporate sustainability encompasses strategies and practices that aim to meet the needs of stakeholders today while reaching to protect, support and enhance the human and natural resources that will be needed in the future.” In the light of this statement, discuss the key drivers which need to be garnered to ensure sustainability.*
- (v) *“The Bali Road Map consists of a number of forward looking decisions that represent the various tracks essential to reaching a secure climate future.” Discuss.* (5 marks each)

Answer 8(i)

The International Labour Organisation (ILO) was created in 1919, as part of the Treaty of Versailles that ended World War I, to reflect the belief that universal and lasting peace can be accomplished only if it is based on social justice. The security, humanitarian, political and economic considerations, were the driving force behind the creation of ILO.

There was keen appreciation of the importance of social justice in securing peace, against a background of exploitation of workers in the industrializing nations of that time. There was also increasing understanding of the world's economic interdependence and the need for cooperation to obtain similarity of working conditions in countries competing for markets. Reflecting these ideas, the Preamble states:

- Whereas universal and lasting peace can be established only if it is based upon social justice;
- And whereas conditions of labour exist involving such injustice hardship and privation to large numbers of people as to produce unrest so great that the peace and harmony of the world are imperilled; and an improvement of those conditions is urgently required;
- Whereas also the failure of any nation to adopt humane conditions of labour is an obstacle in the way of other nations which desire to improve the conditions in their own countries.

The areas of improvement listed in the Preamble remain relevant today, for example:

- Regulation of the hours of work including the establishment of a maximum working day and week;
- Regulation of labour supply, prevention of unemployment and provision of an adequate living wage;
- Protection of the worker against sickness, disease and injury arising out of employment;
- Protection of children, young persons and women;
- Provision for old age and injury, protection of the interests of workers when employed in countries other than their own;
- Recognition of the principle of equal remuneration for work of equal value;
- Recognition of the principle of freedom of association;
- Organization of vocational and technical education, and other measures.

The ILO is the only 'tripartite' United Nations agency that brings together

representatives of governments, employers and workers to jointly shape policies and programmes, to achieve its defined objectives.

Answer 8(ii)

Hazardous or inherently dangerous industry

The industries involving hazardous processes generally handle many toxic, reactive, and flammable chemical substances in the plant operations which are potential sources of different types of hazards at the workplace. If these hazards are not managed properly, the safety and health of the exposed population is adversely affected and become vulnerable to great risk.

In *M.C. Mehta v. Union of India*, AIR 1987 SC 1086, the Supreme Court stated that “an enterprise which is engaged in a hazardous or inherently dangerous activity that poses a potential threat to the health and safety of persons and owes an absolute and non-delegable duty to the community to ensure that no harm results to anyone. *The principle of absolute liability is operative without any exceptions. It does not admit of the defences of reasonable and due care, unlike strict liability. Thus, when an enterprise is engaged in hazardous activity and harm result, it is absolutely liable.*

Answer 8(iii)

The given statement is part of Supreme Court observation in M.C. Mehta v. Union of India case, which is detailed below:

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 as evidence.

In the case following the alarming details given by M.C. Mehta about the extent of pollution in the river Ganga due to the inflow of sewage from Kanpur only, the Court came down heavily on the Nagar Mahapalika (Municipality) and emphasised that it is the Nagar Mahapalika of Kanpur that has to bear the major responsibility for the pollution of the river near Kanpur city. 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. **Just like an industry which cannot pay minimum wages to its worker cannot be allowed to exist, a tannery which cannot set up a primary treatment plant cannot be permitted to continue to be in existence for the adverse effect on the public at large** which is likely to ensure by the discharging of the trade effluents from the tannery to the river Ganga would be immense and it will outweigh any inconvenience that may be caused to the management and the labour employed by it on account of its closure”.

Again in *M.C. Mehta v. Union of India* [1997(2) SCC 411], the Supreme Court was concerned about the discharge of untreated effluents into the river Ganga by tanneries located in Calcutta. According to the Court the scope of the direction issued to the city of Kanpur was enlarged to include various cities located on the banks of the River Ganga.

Answer 8(iv)

Corporate sustainability encompasses strategies and practices that aim to meet the needs of stakeholders today while seeking to protect, support and enhance the human and natural resources that will be needed in the future.

Concern towards social, environmental and economical issues, i.e., covering all the segments of stakeholders are now basic and fundamental issues which permits a corporate to operate in long run sustainably. Following key drivers need to be garnered to ensure sustainability

- *Internal Capacity Building strength* – In order to convert various risks into competitive advantage.
- *Social impact assessment* – In order to become sensitive to various social factors, like changes in culture , living habits etc.
- *Repositioning capability* through development and innovation Crystallisation of all activities to ensure consistent growth
- *Corporate sustainability* is a business approach creating shareholder value in long run.

These may be derived by converting risks arising out of economic, environmental and social activities of a corporate into business opportunities keeping in mind the principles of sustainable development.

Answer 8(v)

At the 2007 United Nations Climate Change Conference in Bali, Indonesia in December, 2007, the participating national adopted the Bali Roadmap as a two-year process to finalizing a binding agreement in 2009 in Denmark.

The Bali Road Map consists of a number of forward-looking decisions that represent the various tracks, essential to reaching a secure climate future. The Bali Road Map includes the Bali Action Plan, which charts the course for a new negotiating process designed to tackle climate change, with the aim of completing this by 2009. To conduct the process, a subsidiary body under the Convention was set up, called the Ad Hoc Working Group on Long-term Cooperative Action under the Convention (AWG-LCA).

To discuss future commitments for industrialized countries under the Kyoto Protocol, the Conference of the Parties serving as the Meeting of the Parties to the Kyoto Protocol established a working group in December 2005, called the Ad Hoc Working Group on further Commitments for Annex I Parties under the Kyoto Protocol (AWG-KP).
